



Russia's Democratic Moment?

**Defining US Policy
to Promote Democratic
Opportunities in Russia**

William C. Martel & Theodore C. Hailes
Editors

Russian Democratic Reform Project
William C. Martel, Director

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Maxwell Air Force Base

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Russian Democratic Reform Working Group

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Patsy A. Hughes	Mark D. Shackelford
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Russia Democratic Reform Working Group

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Summary

The discourse in the United States about the end of the Soviet Union and the emergence of Russia from the ashes of totalitarianism is awash in metaphors. We commonly hear it said that the democratic experiment in Russia is the greatest strategic opportunity in the history of the twentieth century to build a stable and prosperous international order. While these may be compelling symbols for the momentous nature of revolutionary change in Russia, these ideas do not offer much guidance to the United States as we shape our policies toward Russia. What, then, is the problem with the relatively simple notion that the United States has an interest in assisting Russia with its democratic transformation?

To put matters simply, the problem is that the United States is struggling to find an approach for influencing democratic and economic reform in Russia. For the American people, the result is a debate that swings between extremes and thus confuses those individuals who, in principle, support the idea of assisting Russia in its time of trouble. While we might charge that the fault lies with those responsible for crafting US policy to help shape the democratic transformation of Russia, there is a larger responsibility for those who aspire to influence the public debate in the United States about the proper conduct of our policy toward Russia. We believe that there is a fundamental obligation to articulate a strategy which relates what can be done to what should be done. We believe that the United States has not met either of these objectives.

The broad problem is that the notion of democratic and free-market economic reform remains clouded in confusion, as several propositions highlight. First, the term "democratic reform" means more than the creation of a post-totalitarian state. If we use the history of the last several hundred years as a guide, the formation of a democratic state means that Russian power and authority must be balanced between the people and their government. It also suggests that the core beliefs and principles in

Russian society, or what we often call “political culture,” must be redefined to support the notion of decentralized power and responsibility.

Furthermore, we use the term democratic reform to include both political and economic reform. One reason is that with a moment's reflection on the nature of democratic states, it is evident that the discourse on power and money is intimately and inextricably linked to the nature of politics within a state. Another factor is that the nature of the democratic revolution in Russia is not captured by the term “reform”.¹ The events in Russia are vastly more complicated than mere reform because they involve a fundamental reordering of political and economic relations in a society that was under totalitarian control.

While these principles are important in a theoretical sense, they are mere semantics at this moment in Russian political history. The fact is that neither the Russian people nor their leaders — nor, for that matter, the countless observers in the United States and elsewhere — know what democracy in Russia is or how it should operate. In a sense, Russia's democratic moment is being held hostage by leaders who neither comprehend what democracy is nor are united in their commitment to democratic reform. But the Russians, including Foreign Minister Andrei Kozyrev, are anxious to reassure the West that they remain committed to democracy and market reform.²

Second, the time that it takes a totalitarian state to transform itself into a democratic state is bereft of any historical experience or empirical foundation. To be blunt, we simply do not know how long the transformation will take or whether it will succeed. For all we know, the Russian people may have their energies absorbed by democratic reform for ten, fifty, or one hundred years — or the grand experiment with democracy may collapse in civil war and the rebirth of an authoritarian society. Russia faces truly imponderable questions: How long does it take to establish a functioning government with shared powers among executive, legislative, and judicial branches? How long will it take Russia to develop what we loosely call “democratic political culture”? How long will it take to destroy the vestiges of the totalitarian order and replace them with

democratic counterparts throughout all levels of the Russian government and society? It is obvious that just as the answers to these questions remain unknowable, so too will the duration of Russia's democratic experiment remain clouded in doubt.

Russia cannot predict how long democratic reform will take, and therefore it will face numerous unforeseen difficulties. If the Russian people do not have any clear idea of how long it will take for democratic transformation, then how do Russian leaders or the people judge whether their efforts are successful? In the case of policymakers in the United States, doubts about the duration of reform complicate the problems of building and sustaining the domestic coalitions necessary to support democratic reform in Russia. We believe that both Russia and the United States face parallel problems caused by ambiguities about the period for reform. Just as it becomes more difficult to encourage optimism among the Russian people, the debate in the United States about democratic reform in Russia tends to be mired in confusion because we have no clear idea of how long reform might take or how we should judge its success.

Third, the product of democratic reform in Russia is largely unknown. It is essential for the Russian people to have a clear idea of what democracy will yield for current and future generations. While it is easy to sense that the Russian people have put their faith in the unbridled hope that democracy means prosperity and freedom, there is no metric that allows them to judge when that condition is achieved. This condition is dangerous for Russia, because in the absence of standards for judging the success of the effort, the deteriorating political and economic conditions in Russia will manifest themselves as discontent. Any discontent in a disintegrating society is worrisome, especially in a state that is the custodian of 27,000 nuclear weapons.

Fourth, the nature of democratic reform in Russia is more complex given diverse expectations about the process and its outcome. For some Russians, democracy means unbridled prosperity, while for others it means the destruction of the totalitarian order built during the Soviet era. The common theme is the absence of a clear conception of the characteristics of the

society that will replace totalitarianism. The hope that Russia will achieve a market economy at some point is reinforced by the fact that "like everyone else — Russians have responded quickly to market incentives."³ While it is true that enthusiasm in Russia for market economic reform dropped 25 percent in a March 1995 poll in response to economic chaos, the fact is that "the majority of Russians endorsed the Gaidar reforms."⁴

For outsiders, the immediate consequence of democratic reform is to weaken Russia's ability to play an assertive role in international politics, while others hope that a newly democratic Russia will amass the power to act as a counterweight to the strategic aspirations of the United States, Europe, and China. The broader argument is that there are no universal expectations about what democratic reform may produce in Russia — for both the Russians and the outside world who have stakes in the outcome. But we do hope that democracy has a future in Russia and that it will develop into a political, economic, and security partner.⁵

While we focus mainly on Russia, the book examines how the process of democratic reform is unfolding in Ukraine, notably in the areas of governmental and military reform. This comparison is significant because it allows us to observe two states beginning the process of democratic reform from the same condition. The experience of Ukraine is important because, while started in roughly the same place as Russia, it is following a different course in reform. While Russia seems to be moving on a brisk course of reform, Ukraine is moving much more slowly and thus presents an alternative to the Russian model of democratic reform. Finally, Ukraine's position in Eastern Europe provides a litmus test of Russian intentions in the region, notably whether Ukraine will be subjected to pressure from Russia to be reabsorbed.

Why, then, did we write this book? The purpose of this book is to help the American people and their policymakers shape their often discordant thoughts into a coherent policy which assists Russia with its democratic experiment. It begins with the philosophical principle that it is in the national interest of the United States to influence democratic reform in Russia. The corollary of this principle, however, is that how Russia manages

democratic reform is up to the Russian people themselves. As the reader will discover throughout the book, the magnitude of the problem is such that neither Americans nor any other state can be the architects of building a democracy in Russia. Nor should the United States or other states expend enormous political capital and economic resources fostering the illusion that we can.

We fully understand, however, that the success of democratic reform in Russia does not guarantee that the great-power competition between the United States and Russia will come to an end. Whether Russia becomes a democracy is still an open question. Even if democratic reforms succeed, Russia will still compete with the United States in a more restricted sphere, albeit in economic rather than military terms. The US relationship with Japan is an excellent case in point. The fact that Russia is transformed into a democratic state merely transforms the style of competition, but does not mean that Russia and the United States will automatically become allies rather than rivals. The logic of power and interests means that Russia, as a great power, must be expected to pursue its strategic interests, regardless of whether or not those clash with the United States. Our hope that a democratic Russia will be a more constructive member of the international community is not a metaphor for the naive belief that the United States relationship with Russia will be benign.

A fundamental weakness of US policy toward Russia during the period of democratic reform is the failure to prepare the American people for the prospect of a world in which the United States and Russia may pursue competing interests — whether or not Russia becomes a democratic state. The implicit message in US policy over the last several years has been the assumption that a democratic Russia would automatically become an ally. We believe that Russia's interests will make that an illusive goal. The leadership of the United States has an obligation to ready the American people for the possibility that Russia's interests exist independent of democratic reform. To put matters bluntly, the success of democratic reform in Russia may produce a strategic competitor which is vastly more capable and powerful than the Soviet Union ever was. But this would be a success because a

democratic Russia, however competitive, is likely to be a more benign state than the Soviet Union. Our experience since the end of World War II is that democracies do not go to war with one another. The simple conclusion is that, if Russia is a democracy, it will not go to war.

Finally, we firmly believe that there are ways for the United States to help Russia with democratic and economic reform. The problem with the debate in the United States over the last several years is the implicit belief that the success of democratic reform in Russia, or likewise whether we truly care about democratic reform, is measured by the dollars we spend. The United States needs to abandon the current rhetoric of reform as it moves toward a new language which identifies Russia, rather than the United States or other states, as the ultimate agent and determinant of political and economic reform in Russia.

This is no small undertaking given all that has transpired since the collapse of the Soviet Union. The political and economic disintegration in Russia, as evidenced by the Chechnya operation, is obvious on a daily basis. We continue to witness titanic struggles within the Russian government over the very issue of whether reform is desirable or possible. While some observers see the Chechnya operation as an effort to "re-establish a closed society,"⁶ some Russian reformers believe that democracy will succeed despite Chechnya.⁷ The United States faces monumental economic constraints of its own that diminishes its ability to expend great resources on Russia. We have no guarantee that any expenditures will make any significant difference given our fundamental belief that states, rather than outsiders, build democracies. Finally, while the American people are reassured time and again that democratic reform in Russia is important, our policy never seems to match the rhetoric.

The challenge of democratic reform in Russia is greater now than it was even several years earlier. The reality is that democratic reform is a complex undertaking in part because the elements of society are so deeply interrelated. At the same time, support for democratic reform in Russia carries vastly more political baggage in the United States and the West than it did in

the early 1990s. One of the principal reasons for the loss of enthusiasm in Russia and the United States is the realization that building a democracy is vastly more complicated and painful than anyone anticipated. The original burst of optimism and hope in both Russia and the United States for a democratic government was, in retrospect, unrealistic and unattainable. What began as the honeymoon of reform has been transformed into the cold reality of economic dislocation, social upheaval, and the realization that any significant progress will occur in the distant future. While it is proper to believe that Russia's democratic moment is not lost, the challenge of reform elevates this thought to the central strategic question of our time.

Prominent Questions About Democratic Reform in Russia

Our fundamental belief is that the time has come for the United States to refocus the public debate on the prospects for political and economic reform in Russia. To accomplish that, the United States must address several questions as the first step toward articulating the concrete principles and objectives that must shape US policy toward Russia in the twenty-first century.

1. What must Russia accomplish to become a democracy?

The emergence of a democratic state in Russia and a free-market economy will not happen in one or even ten years. But when Russia crosses the threshold of becoming a democratic state, that moment will be the result of a confluence of forces. At that time, Russia will have, among other things, the elements of a legitimate government, a productive economy, and most importantly, a widespread expectation among the Russian people that the rule of law always will prevail. The point is that there are many mechanical steps that Russia must take before it will exist as a democratic state, and that Russia alone must take responsibility for ensuring that those steps are taken.

The problem, however, is that it is intellectually difficult to specify what a democracy is. While we can define a democracy in simple terms, and we all certainly recognize a democracy when we see one, this is not the same as describing how to build one. It becomes

clearer throughout the book that what the West means by democracy is a confluence of factors, often known as political culture, that Russia must embrace if it is to become a democracy. It is easy to say this, but much more difficult to bring to fruition — as the Russian people are learning.

2. What progress has Russia made in democratic reform?

The debate within the United States often fails to recognize that, in the span of several years, Russia has made tremendous strides toward democratic reform. While some argue that Russia remains on a “downward path of disintegration,”⁸ we believe that a broader interpretation is that Russia shows some signs of making the transition to democracy. As recently as 1990, the former Soviet Union still maintained the trappings of totalitarianism throughout all sectors of society. By 1995, Russia had achieved some of the conditions that best describe a constitutional state: a popularly-elected President and legislature; dismantling its command economy; reduced defense spending — although we should note that it did so out of economic necessity rather than choice. By any standard, Russia has made remarkable progress in several years.

The positive news is that the Russian economy had its best year in 1994 since the end of the Soviet Union. The rise in prices was relatively modest and foreign investment has begun to increase, reaching \$2.5–\$3 billion in 1994. Russia's gross domestic product increased 4 percent in October, which represents the first expansion since 1992. Most Russians believe that economic reform is irreversible.⁹ Furthermore, privatization is flourishing and far more extensive than expected, as roughly 50 percent of Russia's economy is created in the private sector, and the Russian budget operates largely in cash rather than credits. These are remarkable steps for an economy barely three years beyond totalitarianism.¹⁰

Why, then, the confusion about democratic reform in Russia? The source of confusion rests with the grandiose expectations within the United States. The West tends to dismiss these accomplishments because Russia is experiencing political struggles and economic collapse. Russia's gross domestic product contracted by 15 percent in 1994, 12 percent in 1993, and 19 percent in 1992.¹¹ We believe that the United States fails to

consider just how far Russia has come, and that failure is based on our inability to relate our own expectations about reasonable progress in Russia. We further believe that the American leadership must redefine the debate about democratic reform. Only then can the United States have a strategic perspective on the policies that must be adopted if we are to influence, however indirectly, the course of democratic reform in Russia.

3. Does democratic reform in Russia depend on President Yeltsin or other specific personalities? The answer is “no” — despite the focus in US policy from the beginning of democratic reform in Russia to link the fate of democratic reform in Russia to individuals. As first Gorbachev and now Yeltsin became the symbols of reform, each personified the hope in the United States that democratic reform would succeed. This course is fraught with perils largely because linking US policy to the fortunes of individuals reduces the ability of the United States to be flexible. But the greater peril is that binding US policy to individuals in the Russian government implies that individuals build democratic states. The more persuasive case, however, is that democratic reform succeeds precisely because the people, in this case the Russians, support reform and imbue their leadership with the legitimate authority to pursue democratic reforms. We believe that the United States must shape its policy to diminish the role of the Russian leadership at any given moment.

The United States is belatedly attempting to distance itself from the Russian leadership, as evidenced by Secretary of State Warren Christopher's recent suggestion that the West should look beyond a Russia with Yeltsin at the helm.¹² We believe that, rather than engaging in efforts to affirm the obvious — that Yeltsin is Russia's elected leader and that the United States will deal with that leader — the United States needs to understand that democratic reform is built by societies rather than individuals. We undermine the credibility of the process in Russia by engaging in public debates about the value of Russian leaders. Frankly, it is time to reaffirm the principle that the United States supports democratic reform in Russia and will work with Russia's popularly-elected leadership.

4. What specifically can the United States do as Russia strives to become a prosperous democracy? The leadership of the United States and the West needs to express explicitly and precisely that the burden for democratic reform rests directly and unavoidably on the shoulders of the Russian people. Only the Russians themselves can propel their society along the path that leads to the transformation of Russia into a democratic state. In this regard, the earlier debate in the United States was misleading and misdirected because it confused the nature of this responsibility. There is growing public dissatisfaction in the United States with giving assistance to Russia, in what some call “aid fatigue.”¹³

In contrast with the earlier debate, the United States must express in deliberately stark terms that the question is not what the United States must do to develop a democracy in Russia — but what Russia itself must do. The United States will benefit from framing the debate in these terms because it will avoid the impression that we, or other states, garner the lion’s share of the responsibility for the outcome of democratic reform in Russia. Russia remains responsible for the outcome of reform, while the rest of the world is confined to a largely supportive role.

The proper relationship between the United States and Russia during this time of transformation is one of guidance as well as assistance. It is a truism that the Russian people must never believe, even for a moment, that the role of the United States is anything more than guidance. Any other suggestion implies that the Russian people are not capable of building their own democratic state, and thus embodies the worst form of condescension. The Russian people are very sensitive to outside pressure, and it is particularly counterproductive if they detect such pressure. It also implies that the Russians should ask the United States for specific guidance, and therefore that the United States should respond in measured ways. We examine some of these throughout the book.

5. What pitfalls does Russia face in creating a democratic society? It is inevitable that the transformation of Russia to a democratic state is littered with potential pitfalls, including the dangers of political paralysis, extreme nationalism, and economic

decay. Any state is vulnerable to these dangers when involved in radical reform. The Russian people and their leadership must understand that this is the case. The implication is that the United States is better prepared than most other states to advise Russia about these dangers and to offer guidance when asked.

This study describes the problems posed by the process of democratic reform in Russia, and policy approaches to managing them, in four parts.

Part I describes the mechanics of democratic reform in the government and politics in Russia and Ukraine. Before those thoughts, however, we begin with an introduction to the problems inherent in democratic reform in Russia. Thus, in Chapter 1 we concentrate on the challenges posed by Russia's non-democratic history. The point that cannot be missed is that Russia is attempting to build a democracy where none existed before, and is doing so in the midst of a political culture for which democratic values are largely alien. In the vein of understanding impediments to democratic reform in Russia, Chapter 2 asks why the United States must concern itself with political and economic reform in Russia. Chapters 3 and 4 focus on the dynamics of the process of democratic reform in the governments of Russia and Ukraine. In these chapters it becomes manifestly clear that democratic reform is an evolutionary process, involving the development of institutions in a society which has only primitive notions of how democratic states operate.

Part II is devoted to understanding the critical issues and forces that shape the democratic reform in Russia's economy and society. The chapters in this section focus on the substantial challenges that Russia must surmount as it attempts to build a free-market economy from the ashes of the Soviet command economy. Chapter 5 outlines how the forces behind the disintegration of the Russian economy are magnified by Russia's inexperience with a market economy. With the profusion of competing views about the proper course for economic reform, Russia lacks a coherent framework for change. At the same time, the theme in Chapter 6 is that those who seek to rebuild Russia's economy must

first build a coherent and systematic system for managing money and building capital in Russia's banking and financial markets.

The problem of economic and societal reform, however, is not simply a matter of paradigms of economic reform. Perhaps the greatest struggle for Russia is to gain control over the forces that are ripping the system apart. Prominent among these, as described in Chapter 7, is the havoc caused by the explosive growth in the black market in Russia since *perestroika*. Most observers of events in Russia are united in their view that the resurgence of the black market constitutes a fundamental impediment to building a free-market economy within Russia. And as we argue later, Russia's leadership must take far more aggressive steps to reign in the growing influence of these elements if the gains from democratic reform are to be protected and enlarged.

Additionally, we examine two of the more contentious issues surrounding the economic and societal reform in Russia. In Chapter 8, we address the role of outside assistance in Russia's efforts to dismantle the command economy, focusing in particular on the function of foreign economic support. The philosophical principle that is embedded throughout this chapter is that outside support plays at best a supporting role, arguing strenuously in defense of the propositions that assistance will not build a free-market economy in Russia, there are material limits to the ability of states to assist Russia, and lastly that the risks of funneling aid inefficiently far outweigh the possibilities of success. The subject of Chapter 9, the challenge of privatizing and converting Russia's defense enterprises, is complicated by the fact that the defense sector dominates the Russian economy. Russia, however, cannot escape the logic of economic reform, which argues that it must reform and essentially downsize its defense sector if it is to compete in the global economy. The greatest impediments to economic reform in the defense sector are its size, illusions that foreign arms sales will subsidize the process, and the absence of coherent views or systematic ideas for reform.

Part III examines how the instruments of Russian power shape Russia's role in international politics in the post-cold war era. This part begins with the state of democratic reform in the

military forces in Russia and Ukraine. Chapter 10 outlines the challenges that Russia must surmount as it reforms its military to fit the needs of a democratic state, and Chapter 11 compares the similar problems confronted by Ukraine as it does the same. Each of these states faces the need to redefine the role of the military in a democratic society. Chapter 12 examines the behavior of the military as an instrument of Russian foreign policy, with particular emphasis on worrisome signs in policy as demonstrated by recent events. Finally, Chapter 13 reviews Russian foreign policy actions in Eurasia with a particular emphasis on Russia's relationship with other members of the Commonwealth of Independent States.

Part IV is devoted to establishing a policy agenda for organizing the efforts of the United States to assist Russia with its democratic reform. Thus, the purpose of the Conclusion is to articulate a framework for strengthening the ability of the United States to promote democratic opportunities in Russia. As we approach the twenty-first century, the United States must articulate a rationale and purpose for its efforts to promote democratic reform. If we fail in this regard, subsequent generations will pay the price for losing the chance to shape Russia's democratic moment.

A Word About the Project

This book is the product of the labors of the Project on Russian Democratic Reform at the Air War College that began in the fall of 1994. The working group, consisting of students and faculty, grew out of the seminar devoted to the study of political, economic, societal, and military phenomena in Russia and Ukraine in preparation for several weeks of travel and research in those states. These views were strongly reinforced by direct discussions with senior governmental and military officials in Russia and Ukraine. What started as an effort to examine several fundamental forces that shape democratic reform in the former Soviet Union quickly evolved into a study on the factors that determine the success of Russia's efforts to redefine itself as a democratic state entering the twenty-first century.

This book reflects the urgency of democratic reform. For Russia and Ukraine, it is apparent that the collapse of the old order, in both its political, economic, and military manifestations, raises the prospect of societal disintegration. Simply put, Russia cannot afford to view democratic reform with complacency. We feel a sense of urgency for the United States as well, which cannot afford to be a bystander as Russia struggles through the process of democratic reform and societal disintegration. To be frank, Russia needs to understand how democratic reform is proceeding and where it is working. The United States needs to be guided by a strategy that provides a sense of direction and purpose to our own efforts in assisting, however nimbly, Russia's efforts to change itself.

In a climate driven by our own sense of commitment to helping Russia succeed in its democratic moment, the members of the Project believe that we can assist those in both Russia and the United States comprehend the process of democratic reform. But more importantly, we believe the greatest challenge, and one as yet unfulfilled, is to craft a strategy for encouraging and assisting Russia in its moment of need. To be frank again, it is clear that the current debate in the United States about assistance to Russia is neither sensible nor sustainable. It is clear that the United States is poised on the edge of a new debate about the proper foreign policy for the United States. This book addresses this critical juncture.

Those who contributed to this book discovered in the course of their research that the questions are many while the answers few. What the United States needs in its own deliberations about policy toward Russia is a sense of purpose tempered by pragmatism. As we explore throughout this book, neither we nor others can rebuild Russia. But we can inject a healthy sense of purpose into a careless debate about what to do with respect to Russian democratic reform. Accordingly, the contributors to this book focused their research efforts on the forces that will have a critical bearing on the success of reform in Russia. And while there are many authors, and thus some occasional duplication of thoughts, we are united by our common purpose of seeking to assist policymakers, both here and abroad, with momentous decisions about what should be done to

maximize the chances that democratic reform in Russia will succeed.

This book is the product of the efforts of the working group who, through their own volition and from no direction by the College, decided that the debate about democratic reform in Russia needed to be more sharply focused and that we can make a worthwhile contribution to that debate.

Acknowledgments

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Notes

1. See Michael McFaul, "Why Russia's Politics Matter," *Foreign Affairs*, January/February 1995, p. 88, for his argument that, "Rather than amend or improve the Soviet command economy, Russia must dismantle it and develop a market economy."

2. See Elaine Sciolino, "Russia Assures Anxious US Of Its Commitment to Reforms," *New York Times*, January 18, 1995, p. A4.

3. See David Brooks, "Russian Culture: Letters," *The National Interest*, Winter 1993/94, p. 107, who cited increased Russian borrowing in the face of negative interest rates.

4. See "The Wrong Way to Aid Russia," *Wall Street Journal*, March 9, 1995, p. A18. The poll reveals that "three out of four Russians oppose development toward a market economy."

5. See Stephen J. Blank and Earl H. Tilford, Jr., (eds.), *Does Russian Democracy Have a Future?*, US Army War College, Strategic Studies Institute, 1994, for a collection of essays on events pertaining to Russian democratic reform.

6. See Michael Specter, "Russians and Rebels In Cease-Fire Agreement," *New York Times*, January 18, 1995, p. A4.

7. See Claudia Rosett, "Russian Reformer Says Democracy Will Prevail Despite Chechnya," *Wall Street Journal*, January 11, 1995, p. A10.

8. For the view on disintegration, see Peter Rutland, "Has Democracy Failed Russia?," *The National Interest*, Winter 1994/95, pp. 3-12.

9. See Steve Liesman, "Russia's Economic News: It's Not All Bad," *Wall Street Journal*, November 28, 1994, p. A14, for this data on the Russian economy.

10. See Charles Wolf, Jr., "The Fine Art of the False Alarm," *Wall Street Journal*, November 1, 1994, p. A20. He derides the pessimistic predictions of Western observers about the progress of Russian economic reforms, but notes that "the Russian economy has not turned the corner," and "confidence in its future would be premature."

11. See "Decline in Russian GDP Widened to 15% in 1994," *Wall Street Journal*, January 18, 1995, p. A10.

12. See Elaine Sciolino, "Christopher Drops Hint: Is Yeltsin Essential?," *New York Times*, March 1, 1995, p. A5.

13. See Amy Kaslov, "US Debate: To Russia With Aid?," *Christian Science Monitor*, March 21, 1995, p.1.

Part I

Democratic Reform of Government and Politics

Chapter 1

Trapped by History: From Totalitarianism to Democracy

by James D. Jewart & Neil G. Kacena

- A. The Problem
 - B. Legacy of Non-Democratic Traditions in Russia
 - C. Impediments to Democratic Reform
 - D. Guidance for US Policymakers
-

A. The Problem

Russia is engaged in a great experiment with democracy. An unresolved question is whether Russia can transform itself into a democratic state with free markets. The outcome of the unprecedented changes in Russia and Ukraine, along with the other Soviet successor states, will be determined by the emergence of political, economic, and legal institutions that are radically different from their historic predecessors. For Russia, the challenge is to manage the ongoing politico-economic revolution in a way that alters, in a peaceful fashion, all facets of government and society simultaneously.

The critical problem for Russia is that it cannot conduct this revolution in isolation. The world is watching the Russian democratic experiment with great interest. Furthermore, how other states perceive events in Russia is influenced to a great extent by their own experiences with political and economic reform. Whether Russia is seen to be successful lies, in part, on highly particular judgments. In the case of the United States, we are watching events in Russia through the lens of 200 years of American-style democracy.

4 ... *Russia's Democratic Moment*

It is inevitable that the fundamental differences between American and Russian experiences with democracy and free markets are significant in historical terms. Our history as well as geography, government, culture, economy, beliefs, and goals evolved differently from Russia's. This reality directly shapes US views about Russian political and economic reform, and more importantly, influences our judgments about the product of Russia's labors. The best evidence that these prejudices and conceptions exist in American politics may be found in the early months of 1992. Former President Nixon berated the Bush Administration for not responding in a decisive fashion to help Russia undertake the monumental task of political and economic reform. Implicit in Nixon's criticism is the view that events in Russia matter, and that the American people are watching and judging.

Democracy has been described as a type of government, a political philosophy, and a way of life. In his book, *Democracy in America*, Alexis de Tocqueville declared that, "The Russians and Americans, starting from different points, seem to be advancing toward the same goal — to one day hold the destinies of half of the world in their hands."¹ But the reality in 1995 is that democracy in Russia is far-removed from its American predecessor. Each system developed as a result of a number of historical traditions and events. This condition is a natural reflection of the fact that the American experience with democracy is the product of peculiar historical and cultural factors. The unyielding truth is that Americans continue to judge the success of Russian democratic reform through the lens of their own democratic traditions.

This chapter establishes a framework for understanding the political culture that is evolving within Russia. There are two reasons for this approach. One is the realization that the virtual absence of experience with democratic institutions or free-market economics in Russia suggests we are witnessing the birth of a new political culture within Russia that will not mirror that in the United States. The second is that the American perspective on the evolution of democracy in Russia inevitably reflects our own experiment with democracy. We believe the process of transformation will provide the framework through which the United States

judges Russia's efforts. The process of transformation will define the political context within which the United States will shape its policies and attitudes toward Russia in the twenty-first century.

A profound consequence of Russia's unique approach to democracy is that Russia inevitably will transform its own ideas about democracy into a form of government that does not mimic that which exists in the United States. The American people need to be reminded to temper their expectations about the revolutionary changes that are in progress in Russia.

B. Legacy of Non-Democratic Traditions in Russia

Russia's Authoritarian History. Government in Russia was historically and traditionally autocratic. The origins of Russian political culture can be traced back at least one thousand years, to the reign of Vladimir I and the Kievan peoples of the land of Rus'. It progressed through the communal traditions of migrating peasants under the tsars, and culminated more recently in enforced collectivism under the Soviets. The Slavic and Finnish tribes that clustered along the Dnieper River in present day Ukraine were ruled by Norse princes. By the thirteenth and fourteenth centuries the Mongols turned the princes into vassals and enslaved the population. In the latter part of the fourteenth century, Russian armies began the campaign that led to the eventual ouster of the Mongol invaders. Princes ruled again, this time from Moscow. In time, Prince Ivan III assumed the title of "tsar" and from that time tsars continued to rule until early this century when communism emerged to hold Russia in its sway. The collapse of the Communist Party, and subsequently the Soviet Union, finally occurred in 1991.² The practical consequence of this thousand-year heritage of autocratic government was the limited opportunities for the Russian people to experiment with democratic forms of government. As a result, Russian political culture is imbued with the belief that direction is provided by the government rather than emerging as the product of individuals in a decentralized government.

Philosophical Tradition of Communism. With the Bolshevik Revolution in 1917, Russia began a 70-year experiment

with communism and totalitarianism. The ideology of communism coincided neatly and conveniently with Russia's autocratic history. We need to understand that many Russian concepts, including centralized control and the dominance of government over the individual, were subsumed by the Communists. And thus, while it is not difficult to pinpoint the origin of the ideas that shaped government in the Soviet Union during the totalitarian era, it is less clear why communism prevailed for as long as it did in Russia.

In the end, communism succeeded in Russia largely because Russians had no prior experience with participatory government. Communism lasted in Russia for more than 70 years, following centuries of tsarist governments which were equally repressive. This history is significant because it raises the question of whether Russia's non-democratic traditions imperil current efforts to move Russia toward a democratic society.

Role of Religion in Russian Society. Religion has been an integral part of the social fabric of Russia since the baptism of Vladimir I in 988. When the Tatars conquered Kiev in 1240, the center of religion shifted to Moscow. Historically, the church permeated many aspects of life in Russia and most Russians have identified themselves as members of the church. The church exercised moral authority over all Russians, and the church, more than any other institution, "expressed the character of the Russian people and their essential unity."³ In times of national emergency, the church united and inspired the masses.⁴ Although Stalin and Khrushchev tried their best to eliminate the church from Russian society, it proved extremely resilient. Clearly, the church shaped the individual as well as society throughout Russia's history. Its influence and impact survived not only the secularization of politics in Russia by Peter the Great, but also the atheism of Marxist Communism.⁵ And now, the church is playing a central role in Russia's attempt to recover its earlier traditions.⁶

Gradual Democratic Reform in Russia? It is, then, perfectly understandable why the Russians may be slow to adopt a different way of thinking about the relationship between individual and state. While democracy fosters the idea that people survive in an individualistic world, history created no such

democratic imperative for the Russians. The question for Russia is whether it can become more democratic, or whether Russian history is so inherently anti-democratic as to preclude reform. Yet, there are signs that democratic reform is making gradual progress in Russia. As we explore in subsequent chapters, Russian society is slowly and fitfully moving toward the political and economic pillars of a democratic order.

Treacherous Traverse to Democracy. We believe that Russia must traverse treacherous terrain in the search for democracy and free markets. There is no doubt about the magnitude of needed reform. One observer argued that those who advocate democracy and free markets in Russia, "are defying a thousand-year history of autocratic rule."⁷ One argument is that Russia's 70-year experiment with centralized government precludes the creation of a collective or institutional memory on the concept of a free market and the mechanics of developing one in Russia. As a matter of principle, we do not believe that Russians, any more than other societies, "are incapable of democratic ideals or free markets."⁸ Nevertheless, it is important to understand how far Russians must travel to redefine the ideas that shape political and economic discourse in their society. The great challenge for Russia will be to reverse the ethic which elevates the role and responsibility of the state above that of the individual.⁹

C. Impediments to Democratic Reform

The one thousand year history of Russia provides no precedent for a political system that institutionalizes the force of law and executes universal laws through duly elected representatives of the people. The dominant characteristic of governments in Russia was rule by autocratic governments, foreign powers, Russian tsars, and the communist party hierarchy. In a political tradition ruled by foreigners, tsars, and the communist party, the Russian people gained no experience with republican government. Even declarations of the rights, responsibilities, and limitations of the Russian government tend to be superseded or ignored by political groups in Russia today. Indeed, much of what passes for government in Russia in 1995 is hardly consistent with the

western spirit of democracy. The practical result of democracy in Russia today reflects an underlying tendency toward an autocratic government that operates in parallel with a highly inefficient command economy. What follows is a series of impediments to democratic reform that Russia must address and resolve before it can join the modern western world.

Societal Breakdown. The most significant challenge to the emergence of democracy in Russia is the current breakdown in its society. While the ultimate success or failure of democratic reform in Russia depends on the people, it is difficult for the average Russian to bear the current misery. They face the unenviable combination of profound uncertainty about the future, a major breakdown of law and order, and an erratic economy that leaves considerable doubt about the ability to obtain food, clothing, and shelter. While the Russians have a weakly articulated concept of what democracy means and how it operates, they do not have an infinite supply of patience as their society careens from crisis to crisis.

Absence of Democratic Norms. The strength of democratic governments is their ability to institutionalize the concepts of majority rule, individual rights, toleration of minority views, and republican forms of representation into a system of government. None of these concepts are part of political discourse in contemporary Russian political culture. Politics in Russia today best resembles an uncontrolled process of competition within the government and among various ideological factions. The dominant feature of political competition in Russia is a contest between individuals or groups rather than between established branches of government. The current struggle for power between the executive and legislative branches is highly personalized and demonstrates that the old forms of competition for power continue.

The current squabbles between the executive and legislative branches demonstrate that Russians, for now, have no practical understanding of the concept of political compromise. The absence of political compromise creates a potentially divisive force in Russian politics. In this case, there are evident growing pains in Russian politics. How can the government return to a degree of

normalcy if the branches of government are involved in constant struggles rather than working to resolve Russia's truly monumental political, social, economic, and military problems? While we acknowledge that political frictions exist in all democratic states, in Russia these frictions reach levels that cripple the democratic process.

Inchoate Parties and Factions. By the summer of 1992, there were in Russia more than one thousand political parties, movements, and foundations, including 25 which were formally registered. Individually, these political parties are characterized by small numbers and an inability to create even a modicum of a national consensus or a majority coalition. At best, Russian political parties represent splinter groups and factions which exist in such large numbers that it is difficult to shape coalitions for the passage of legislation. In the current Duma, roughly 20 political parties, factions, and parliamentary groups are represented. This miasma of political parties creates a significant impediment to the process of democratic reform, in part due to the difficulties of forging working parliamentary majorities. This profusion of political parties can also be taken as a sign of political health because it demonstrates that the Russian people are interested in the political process. Unfortunately, Russia will not have a stable and productive government until those parties coalesce into working majorities. In the meantime, the existence of inchoate parties poses a fundamental threat to the development of democratic government and rule in Russia.

Influence of Old Communist Elites. It is no exaggeration to say that many of the officials in the Russian government cut their teeth in the politics of the totalitarian order. The fact is that a great many of the members of the Duma, for instance, were from the privileged class. In the business sector, many enterprises are owned by individuals from the old political order who used their personal connections and influence to amass the capital necessary to acquire firms. Whether their recent conversion to capitalism has more to do with personal advantage than principle is beside the point. What is relevant, however, is that the continued presence in power of the old elites tends to reinforce the impression that the

rules of government are substantially unchanged. There are reasons to believe that the ability of these elites to use their former position in the communist order to take advantage of opportunities in the marketplace increases the disenchantment of the average citizen with the democratic process and undermines the belief in legitimacy as a principle of government. Facing an uncertain future and a declining standard of living that is worse in many cases than it was under the communist regime, the average Russian citizen may see the persistent influence of old elites as a sign that the system is not working fairly, and that perhaps it is necessary for a populist leader to restore order in their lives.

Violent Tendencies. Nor is there an ideological foundation for peaceful and evolutionary means of change. Endemic in the Russian experience is a tendency to resort to violent revolutions as an instrument of change. The revolution which overthrew the tsar in 1917 was followed by the Bolshevik revolution seven months later that ignited a devastating civil war. Although the current political revolution began with the relatively peaceful transfer of authority in 1991 from the Communist Party of the Soviet Union to the current government of Russia, in the span of three years Russia experienced a coup attempt in 1991 and a constitutional crisis between President Yeltsin and the Supreme Soviet that led to gunfire in the streets of Moscow in 1993. Although the process of democratic reform was largely peaceful, there are worrisome signs of danger in this still incomplete revolution.

No Moral Framework for Secular Politics. A further impediment stems from politics in Russia that historically weakened the role of individual beliefs and moral values.¹⁰ A tragic effect of scientific communism was to undermine the moral values that we see as the foundation of democratic government. The consequence is that Russia has yet to create a moral framework that is essential to building a democratic form of government. As George F. Kennan wrote in his famous telegram, "In the name of Marxism they sacrificed every single ethical value in their methods and tactics."¹¹

No Republican Precedent. The notion of representation did not exist in Russian governments which, from the times of Tsarist monarchies to communist autocracies, ruthlessly concentrated power in the hands of the few. While Alexander II introduced the first formal district assemblies in 1864 and Nicholas II convened the first Duma in 1906, both legislative assemblies were not independent of the monarchy.¹² There was no significant basis for republican government in Russia prior to 1991.

Judicial Vacuum. There is no significant experience in Russia with an independent legal system. Despite occasional attempts at reform, the legal system remains a creature of the state. While there were efforts beginning in 1864 to establish an independent judicial system with jury trials and guarantees of equal treatment, the legal system never transcended the influence of the tsar or commissar.¹³ Even today, Russia cannot be said to have an independent judicial system.

The judicial branch in Russia faces a particularly difficult challenge until it is established as an independent branch of government. The establishment of a society based on law is the basis for building a solid foundation for democracy, for without laws there can be no trust, and without trust there can be no democracy. Russia must establish a legal system for a country that has no practical experience with independent laws or institutions. Until it does so, Russian society will continue to operate in a legal vacuum. The challenge is to create judicial institutions that are able to maintain the boundary between the individual and the government in a culture that is unfamiliar with the concepts of limits on the power of institutions. A balance of power among competing institutions of government is vital for the long term health of democracy in Russia. The economic sphere is equally handicapped by an impotent judiciary. Foreign investors are loath to enter a market in which contracts are not supported by the legal system. Internal economic activity is limited for the same reason.

All Power Flows from Moscow. Since the reign of Ivan the Great when the Russian land mass was consolidated in the early sixteenth century, power in Russia traditionally flowed from the central government in Moscow outward to the rest of the society.

While the various non-Russian republics, autonomous republics, and autonomous districts that ultimately developed were allowed to maintain the central identity of their local culture, they had little political or economic power, despite grandiose promises in the constitution.¹⁴ Moscow has traditionally been the seat of Russia's political power, economic assets, and military force. The insularity of the capital led some to describe Moscow as "a single rich island in a pauperized country."¹⁵

Fundamental Rights and Freedom. The Russian political system must establish tolerance through the protection of individual rights. In other words, Russian political ideology must increase individual freedom while simultaneously minimizing the power of the government. What Russia needs to establish is a constitutional system of government that protects the fundamental rights and freedoms of the individual. More specifically, Russia must establish limited government and provide a legal framework within which justice, domestic tranquillity, the common defense, and the general welfare of the citizens can express themselves.

No Institutional Checks and Balances. One of the fundamental impediments to democratic reform in Russia is the virtual absence of an understanding among politicians and citizens alike of the role of checks and balances in a democratic government. In the absence of established traditions of power and compromise in government, the norm is defined by the struggles between President Yeltsin and the Duma on the one hand, and Yeltsin and the judiciary on the other. Neither understands the art of political compromise nor engages in the normal political give and take among the executive, legislative, and judicial branches that is the hallmark of democratic government. In the Duma alone, the quarrelsome behavior of the legislators frequently leads to paralyzing debates over procedural points and a disputatious quality to Russia's legislative sessions. It is only when the nascent institutions of the government in Russia acquire a clearer sense of power and institutional prerogative, leavened by a sense of legitimate differences of view, that normalcy can become the rule to politics.

Unresolved Separation of Powers. Without a clear understanding of institutionally separate spheres of power, Russian politics is mired in constant struggles over the power of the respective branches of the government. One of the greatest challenges for Russian democratic reformers is to codify and instill within the government the principle of the separation of powers.¹⁶ The people in Russia who are engaged in democratic reform need to understand and resist the principle, as enshrined in Lord Acton's famous maxim, that "power corrupts, and absolute power corrupts absolutely." The surest way to limit the ability of government to abuse power is to establish a system of checks and balances on the power of the executive, legislative, and judicial branches of government so that no one branch is supreme. The notion of the separation of powers cannot develop spontaneously in Russia, but will be in a continuous process of development throughout the life of the republic.

Legitimate Representation. The success of democratic reform, therefore, rests largely on the extent to which the government in Russia is perceived by the Russian people as a legitimate instrument of representation. To achieve legitimacy, Russia's government must establish the precedence of individual rights over government through the instrument of codified individual and minority rights. The corollary is that representation through a republican form of government creates a society which resolves multiple points of view without resort to violence. As long as each viewpoint is represented and parties are willing to compromise, the Russian people will be able to accept the political system as legitimate.

D. Guidance for US Policymakers

There are several observations about the evolution of democracy in Russia that relate directly to the conduct of American foreign policy.

No Mirror-Image of US Democracy. The success of the democratic system in the United States leads to the tendency by Americans to believe that democracy in Russia will be a mirror image of their own government. Policymakers in the United

States, as well as the American people, must understand that democracy, in whatever form, will emerge in Russia as uniquely Russian. The Russians are not compelled to build a democratic system that mirrors the United States. A significant reason for the debate in the United States about democratic reform in Russia relates directly to the questions, "Why isn't democracy in Russia the same as our own?" and "Why are the Russians taking so long to build a democracy?"

This is a perfectly reasonable question from an intellectual point of view, but it is dangerous if we expect the Russian people to accept *carte blanche* what the United States has learned about democracy. We believe that the Russian people are likely to be more circumspect as they evaluate the strengths and weaknesses of a democratic form of government, and that they may well take decades if not longer to build a true democracy in Russia. Those policymakers in the United States who are responsible for shaping policies toward Russia might be wise to consider how far Russia has come and equally how long they may take to reach what they, and we, might call a democracy.

US Expectations too Grandiose. It is only natural that the American experience with democracy will have a profound effect on US policy toward Russia's emerging system of government. It is easy to forget that the United States has been building a democracy for more than two hundred years, and that by our own timetable the Russian people are moving rather quickly. For example, it was roughly 16 years — between 1787 when the Constitution was ratified and 1803 when the power of the Supreme Court was first tested in the case of *Marbury vs. Madison* — before the powers of the judicial branch of government were firmly established. By that measure, Russia's judicial branch should have its first test in the year 2007.

When we consider that Russia must build a democratic state while simultaneously rebuilding a command economy from the ashes of communism, Russia's relative political and economic stability look somewhat more remarkable. While we do want to be boosters for Russia, we believe that it is essential for the United States to understand that grandiose expectations about

democratic reform in Russia can poison the dialogue between the two states. The task of building a democracy presents herculean challenges to Russia as it slowly learns to transform the intellectual and social basis of politics in modern Russian society.

Russian Democratic Reform Will Take Generations.

There is no escape from the proposition that it will take generations, perhaps even a century or more, for Russians to build a new political order. During that time of transition, it will be necessary for Russia to reject the old notions of communism that once were seen as revealed truth to hundreds of millions of people. Given the ideological baggage carried by the Russian people, it is wholly unrealistic to believe that people nurtured on a steady diet of Marxism can instantly comprehend and willingly adopt the ideas of their adversary to shape their new government. A clear limitation in Russia today is that its leadership is steeped in the traditions of the old communist era. While many of Russia's new democratic leaders want to repudiate the failed experiment of the past 70 years, communism is a deeply-entrenched legacy in Russia. It is interesting to note that while President Yeltsin's legacy was built on his support for democratic reform, we must ponder whether his willingness to issue hundreds of presidential decrees is more consistent with earlier non-democratic approaches to governance.

Hope of US-Russian Partnership. There is nothing wrong or naive about the hope that the United States might enter an era in which we forge a relationship with Russia that is based on shared interests, and which produces a period of peace and harmony. We certainly are entitled to hope that, as Tocqueville said, the Russians and Americans are advancing toward the goal of holding the destiny of the world in their hands. Tocqueville would have been just as surprised as the contemporary reader to hear Boris Yeltsin declare, before a joint session of the United States Congress on June 17, 1992, "Acting on the will of the people of Russia, I am inviting you, and through you the people of the United States, to join us in partnership in the name of a worldwide triumph of democracy, in the name of liberty and justice in the twenty-first century."¹⁷

But in statecraft hope cannot triumph over reason. While there may be legitimate reasons for optimism, a time of strategic cooperation is a long way off. Russia's recent policies toward Iran and Bosnia, for instance, do not bode well for those who see cooperation as the watchword for US-Russia relations. And while we have no choice but to use US policy to promote cooperation with Russia, these hopes must be tempered by the judgment that our goodwill now will not necessarily translate into shared interests with Russia later. We certainly may hope that this will be the result of democratic reform in Russia, but it is not foreordained.

Limited US Influence on Russia's Transformation. Above all else, the American people and their leaders must understand that Russia ultimately is responsible for the outcome of its efforts to reform. Russia is a product of its authoritarian background and expansionist habits, and thus there remains a danger it might reenter a period of conflict and competition with the West.¹⁸ But it is beyond the ability of the United States to shape democracy in Russia, no matter how hard we try. While it is important for the United States to influence Russia's reform efforts, the premise must be that our influence is limited at best. The danger with the current debate in the United States is the presumption that we can shape democracy in Russia. Yet nothing is further from the truth. We are observers of a great experiment in democratic reform that may, but certainly will not necessarily, produce a democratic state in Russia.

Notes

1. See Allen Lynch, "Postcommunist Political Dynamics: Ex Uno Plura," *RFE/RL Research Report 1993: The Year In Review*, January 7, 1994, p. 1.

2. See Lilia Shevtsova, "The August Coup and the Soviet Collapse," *Survival*, Spring 1992, pp. 5-18.

3. See Nicolas Zernov, *The Russian Religious Renaissance of the Twentieth Century*, New York: Harper & Row, 1963, p. 36.

4. See Helen Iswolsky, *Soul of Russia*, New York: Sheed & Ward, 1943, p. 2.

5. We should point out that it was through the church that the Cyrillic alphabet was introduced, thus effectively isolating Russia from Western influence.

6. See Wallace Daniel, "The Vanished Past: Russia's Search for Identity," *The Christian Century*, March 17, 1993, p. 295.

7. See Malcolm Gray, "Red Tide Rising," *Macleans*, Vol. 107, No. 7, February 14, 1994, p. 21, for the argument that, "inexperienced Russians are trying to build a modern free-market economy in a land where individual initiative was sapped by more than seven decades of rigid communism."

8. See "Russia: The Sixth Wave," *The Economist*, December 5, 1992, p. 4, for the view that, "extensive comparative research shows they [the Russians] are just as tolerant of income inequalities as Americans are..."

9. See Kyril Tidmarsh, "Russia's Work Ethic," *Foreign Affairs*, Vol. 72, No. 2, Spring 1993, p. 76, who argues that the Russian reflex is to believe that "material improvement would not come due to any change in their own motivation but rather as the result of some administrative action taken by the state."

10. Daniel C. Diller, *Russia and the Independent States*, Washington, DC: Congressional Quarterly Inc., 1993, p. 426.

11. Dean Acheson, *The Korean War*, New York: W.W. Norton & Company, Inc., 1969, pp. 6-7.

12. Diller, p. 20.

13. *Ibid.*, p. 21.

14. *Ibid.*, p. 283.

15. See John Helmer, "Moscow Keeps Head-Lock on Russia," *The Moscow Tribune*, September 21, 1994, p. 1.

16. Of course, we realize that parliamentary systems of government are democratic, even if they do not operate on the basis of a separation of powers. While we use the separation of powers to characterize efforts to protect individual and minority rights, the real issue is that Russia is seeking to instill the notions of limited government, popular sovereignty, free elections, minority rights, majority rule, and the consent of the governed in its system of government. The reader must fully understand that not all democratic systems are arranged in this fashion. However, since Russia apparently decided to follow the US system of building a government with three branches, rather than a parliamentary system of government, the separation of powers is exceedingly important in the Russian context. The remainder of the book emphasizes this point, all the while realizing that we are bound by the Russian political context and not some absolute or eternal principle of democratic government.

17. Diller, p. 215.

18. See William Safire, "Strategic Dilemma," *New York Times*, December 1, 1994, p. A17.

Chapter 2

Is Russian Democratic Reform Vital to the United States?

by Scot W. Jones & Charles E. Byrd

- A. The Problem
 - B. United States Has Significant Interests in Russian Reform
 - C. Recommendations for Action
-

A. The Problem

The United States has a vital interest in the successful outcome of the Russian struggle to establish a democratic government and free-market economy. By any standard, Russia remains a powerful country with vast resources, talented people, and a substantial military capability. It has the potential to become an enormous market for US products, and its location magnifies its strategic importance to the United States as well as Europe, the Middle East, China, and Japan.

We do not understate the problem by observing that, if Russia is successful in making the transition to a democratic society, it can become a powerful friend and ally in a new era of international peace and prosperity. But if reform efforts in Russia are unsuccessful, it will pose profound difficulties for the United States and the rest of the world. Accordingly, this chapter examines several propositions that define the nature of this interest.

B. United States Has Significant Interests in Russian Reform

There is a nearly universal consensus that it is in the best interests of the United States for democratic reform in Russia to succeed. Most US policymakers believe that the spread of a

democratic and free-market Russia will contribute to a more secure and prosperous international order.¹ The implicit assumption is that democratic states with prosperous economies and strong outside trade links are less likely to wage war with other democracies, sponsor terrorism, or encourage instability.² In other words, the United States must aid the development of democracy and market economies in Russia, because Russia has a significant influence on our interests. If the United States can help foster democratic and market reform in Russia (and the other newly independent states), we will have taken a major step in the transformation of the only state that can threaten our existence. There are several reasons why vital US interests are at stake as Russia struggles with democratic and free-market reform.

1. US Interest in International Stability and the Russian Wildcard

The direction Russia takes in the post-Communist era is critical to international stability and has profound implications for international peace and security. A stable and democratic Russia alleviates one source of security concerns for many states in Eurasia, and simultaneously creates new markets and trading partners throughout the region. The danger is that a politically unstable Russia will foment turbulence and thereby weaken international security. This is largely because international instability forces states to expend resources on military preparations for contingencies that are the product of an uncertain future.

Benefits of Russian Cooperation. The historical record is clear about the significance of Russia in international politics. As one of the central figures in international affairs for the last 50 years, it is particularly difficult for Russians to come to grips with their loss of status as a world superpower. It is inescapable that Russia will seek to gain a place in international politics that accords with its political and military power. Furthermore, the United States is obligated to shape an international order that recognizes the role of Russia as an important building block in establishing a "democratic peace."

There are reasons for optimism, even if they appear somewhat dim in the early months of 1995. After the collapse of the former Soviet Union, we witnessed some of the advantages that accrue when Russia adopts a more cooperative stance in international politics. The zenith of cooperation occurred in the 1991 Persian Gulf War when the Soviet Union directly supported the efforts of the multi-national coalition, and more pointedly, did not use its veto in the United Nations Security Council to prevent US efforts to marshal a coalition against the former client state of Iraq. The Gulf War not only demonstrated the value of building consensus with Russia before taking action, but also reinforced the point that Russian cooperation during the War reinforced Iraq's isolation and strengthened the subsequent regime of economic sanctions against Iraq in the succeeding four years.

Russia Reasserts National Interests. The United States is increasingly concerned with the emergence of less positive signs in Russia. In contrast with the earlier motif of cooperation, Russia is spearheading the movement to lift economic sanctions and normalize relations with Iraq. In a similar vein, Russian diplomatic efforts on behalf of the Bosnian Serbs continue to complicate the admittedly clumsy diplomatic efforts of the United States and NATO to broker an end to the conflict. The consequence of Russian diplomacy is to strengthen the Serbs while weakening the position of NATO and the United States. The broad danger is that Russian diplomatic efforts, as manifested in Iraq and Bosnia, may be a harbinger of times when Russian interests diverge further from those of the other members of the international community. As its economic situation improves, Russia will wield much greater diplomatic and military power in ways that have the potential to weaken international security. Nor can we forget that the foreign policy card has enormous power in Russian domestic politics because it demonstrates that Russian nationalists will not sacrifice their role in international politics to other states.

Russia Determines Peace and Prosperity in Eastern Europe. The fate of Eastern Europe is tied directly to the course that Russia chooses over the next several years. Eastern European states are watching events in Russia closely, for they understand

that a democratic Russia reduces many of the security concerns that historically have dominated the region.³ Russia determines to some degree whether Eastern Europe can attain long-term economic success and political stability. In an ideal world, Eastern Europe and Russia are potentially major trading partners as their economies make the transition from centralization to free markets. Both sides can use the other as a realistic yardstick of progress, rather than using the United States, Western Europe, or Japan as the model for comparison. It is unlikely that economic development in Eastern Europe and Russia will move in tandem. One reason is that Eastern Europe possesses the advantages of at least some democratic traditions and experience with private enterprise. The hope is that political and economic reform in Russia and Eastern Europe can lead to peace and stability in the region.

The objective of NATO's Partnership for Peace is to include the emerging democracies of Eastern Europe and Russia in a collective security agreement in order to strengthen European security. The abiding hope of the United States is that states of Eastern Europe — and perhaps Russia — eventually will join NATO as full members with eventual involvement in NATO planning, operations, and joint military exercises.⁴ However, the problem is Russia's reluctance to join the Partnership and its opposition to the entry of Eastern European states and newly-independent states into NATO is serving as a point of friction with the United States.⁵ Russia fears that the Partnership will lead to its strategic encirclement and the loss of buffer states. Nevertheless, the inescapable reality is that Russian participation is essential to US and European efforts to build peace and security in the region.

Russia Also Determines Asian Balance of Power. As China, Russia, and Japan forge a political, military, and economic balance of power in Asia, Russia's emergence as a more assertive actor in international politics poses dangerous consequences for Asia. This is particularly true as China and Japan shape their policies to counterbalance the historic power of Russia. The development of a democratic Russia with a prosperous free-market economy is a form of insurance against frictions in Asia if it leads to greater economic interdependence in the region. For now, the

balance of power is shifting in favor of China as its economy continues to expand at a breakneck speed of up to 15 percent annual growth. The reality is that Russia and China are bound to remain perpetually wary of each other for reasons which include geopolitical competition, military capabilities, and historical animosities. Russia's relationship with Japan hinges on the prospect of greater trade between the two states as well as the resolution of the Kurile Islands dispute.

Russia is Counterweight to Turbulent Islamic Crescent.

Russia's southern border forms a crescent-shaped area that is populated by several Islamic states, including Iran, Tajikistan, and others. There is a growing risk that these states which are united in their allegiance to Islam pose a threat to stability in the region. A strong Russia can act as a steadying force in this historically turbulent region, and deter states and movements that seek to foment instability. We note, however, that the incursion by Russian forces into Chechnya does not bode well for relations with the Islamic world, and thereby jeopardizes Russia's ability to create stability in this strategically critical area adjoining Europe, Asia, and the Middle East.

Russian Credibility in the Near Abroad. Whether Russia will be able to play a constructive role in international relations will be judged largely by its ability to manage relationships with its former republics. If Russia is able to resolve these disputes in an equitable fashion in accordance with international norms, it will garner the ability to play a constructive role in international politics. If Russia resorts to heavy-handed solutions, it may forfeit the credibility necessary for it to make a significant contribution to the creation of a stable international order.

Russia's Role in Managing Nuclear Proliferation. As long as the world seeks to control the proliferation of nuclear weapons, Russia clearly plays a decisive role. The concern is that nuclear materials are smuggled out of Russia and the newly-independent states and the disposal of nuclear inventories. Chronologies of illicit exports of nuclear materials highlight this problem.⁶ In late 1994 six pounds of weapons-grade uranium were seized in the Czech Republic, and Germany police made four separate seizures

of nuclear materials.⁷ Given current economic and social conditions in Russia and the apparent lack of strict control and accountability, there is an enormous potential for the proliferation of nuclear materials, components, delivery systems, and technical expertise through the black market. The sums of money involved can easily corrupt individuals in Russia's nuclear industry and the military.

2. Russia Shapes US National Security Planning

Now that we have examined the ability of Russian to influence the interest of the United States in international stability, it is important to consider the more direct effect that Russia has on US defense planning. Perhaps more than any other state, Russia will continue to play a prominent role in how the United States thinks about its national security interests. The sheer size of Russia's military forces, as well as its economic potential, argues that Russia is the principal state that can affect US security interests. The danger is that if Russia's experiment with democracy goes awry, we may see a resurgence of hostility toward the United States and Europe. There are several ways in which Russia remains the single most significant influence on US security interests.

Russia Remains Formidable Military Power. Despite the rhetoric of reform, Russia remains a formidable military power in both the conventional and nuclear realms and appears increasingly less willing to reduce its nuclear arsenal.⁸ Although Russia's military readiness has diminished greatly in the last several years, it continues to field new weapons. The United States cannot afford to dismiss the potential power of Russia as a military adversary. Russia continues to engage in sales of advanced military equipment because it provides a major source of hard currency for the government and helps to subsidize Russian military research and development. Sales of advanced weapons to Iran and China demonstrate that Russia's defense industry represents a security problem to the United States.

As one of the nuclear superpowers, Russia possesses an enormous stockpile of nuclear weapons and large, if somewhat less capable, conventional military force. Despite the debacle in Chechnya, the Russian military is the second largest in the world and clearly has the ability to mount significant military operations on the Eurasian continent.⁹ For these and other reasons, the behavior of Russia directly bears on US perceptions of extant military threats. If democratic and free-market reform in Russia were to collapse, the United States must prepare to meet this potentially hostile threat through a variety of measures, including increased defense spending.

Effect on US Defense Expenditures. Since the end of the Soviet Union, the United States had the luxury of engaging in a broad downsizing of its military forces. The argument was that with the disintegration of the Soviet Union, the United States had the opportunity to spend less on defense and thereby invest in the non-defense sectors of the economy. Events in Russia have a significant effect on national security planning in the United States because the outcome of democratic reform in Russia determines to a large extent "how much is enough" in US defense spending. To be precise, circumstances in Russia are important to US military spending on two levels. The first is the need to counter a threat from Russia if it moves in the direction of a fervently nationalistic, expansionist government that portrays the United States as a global adversary. A second concern is the threat of direct or indirect Russian involvement in exports of dangerous military technologies through legitimate or covert sales or through the smuggling of these items. The overall consequence of reform in Russia is significant once we realize that Russian extremism can compel us to increase our defense expenditures at the very moment we hope to strengthen the domestic economy of the United States.

Fears of Russian Economic Collapse and Instability. Russia is gripped in a condition of economic deprivation that contributes to a climate of social dissatisfaction. Conditions in Russia have been difficult for so long that the people expected to see a decisive improvement in their standard of living under the

new political and economic system. The policies of the Russian government thus directly affect political and economic stability in Russia. A legitimate fear is that the declining standard of living in Russia jeopardizes democratic and free-market reform. In that case, the Russian people may look to a more authoritarian government to restore order and status. We cannot forget or ignore the dangers posed by the combination of economic collapse and nationalism in a heavily-armed state. Far more than any other problem, the combination of social chaos and economic instability during the transition could trigger a violent restructuring of the Russian government along nationalist lines. Whether that circumstance provokes another round of the cold war between Russia and the West is uncertain, but the odds do not favor peaceful engagement in such a world.

US Hopes for Peaceful Engagement, Not Strategic Hostility. Under the Clinton Administration, the United States embarked on a course in foreign policy that encourages relationships forged on the principles of peaceful engagement rather than the strategic hostility of the cold war. There is no more prominent case of a state with whom a partnership is useful to the United States than Russia. The prospect of a Russia that is fully integrated in trade and economic discourse with the global economy clearly serves long-range US interests. The hope, and perhaps the reality, is that Russia could not withdraw from the international economy, pursue a posture of international isolation, or risk the resumption of a period of strategic hostility with the West without incurring painful penalties. In this sense, there is merit in the classic arguments that political and economic interdependence foster a cooperative diplomatic order that enables states to resolve differences without the use of force, and thus to create a stable and prosperous international order.

3. Russia's Economic and Market Potential

The involvement of the United States in world affairs today is firmly rooted in the belief that economic exchange serves the broad interests of the society. The Persian Gulf War and granting most favored nation trade status with human rights in China are

testimony to this principle.¹⁰ The fundamental notion is that the United States wants Russian reform to succeed precisely because it will contribute to economic prosperity. While Russia cannot easily go back to the economic or political ways of the Soviet era, there is a danger that Russia could revert to autocratic or authoritarian government. And that in turn could destroy the political and economic freedom that Russia is trying to achieve.

The Danger of Reversal. The United States would pay dearly if Russia were to reverse its present course of economic reform. In terms of political stability, cutting subsidies to the powerful lobbies of industry, agriculture and the military, without clear signs of progress for the Russian masses would have a tremendous backlash. It would dramatically drive up unemployment in the short term — estimated at 10 percent in 1994¹¹ — and place many disaffected voters on the streets prior to the national elections to be held in 1995 and 1996. The people most affected would harbor the same disenchantment that elected radical right-wing nationalist Vladimir Zhirinovsky to the Duma.¹²

A substantial shift in the Duma to ultra-nationalism would most naturally benefit the communists. Unlike many of the communists now in control of many of the East European states who are *nomenklatura* capitalists, Russian Communists remain opposed to the advancement of capitalism in Russia. A simultaneous reversal of power within the government, coupled with a collapse of economic reform, would potentially lead to reinstatement of a more autocratic government. With it, the West's fears of Russia's imperialistic tendencies and its destabilizing effects on the international system could come true.

Economic Importance to the United States. It clearly is important to the United States for Russia to emerge out of this economic quagmire and thus to build a solid foundation for the successful growth of a free market economy. A prosperous free market economy is essential to ensure Russia's future political stability and prevent a return to authoritarian politics. In turn, a stable Russia that pursues democratic governance serves the best interests of the United States. Our current national security strategy of engagement and enlargement emphasizes the

importance to US security of, "protecting, consolidating, and enlarging the community of free market democracies."¹³ The United States needs to focus its efforts on preserving democratic processes in key emerging democratic states, such as Russia.

Russia's Vast Trade Potential. The hope is that a Russian free market will enhance prospects for international investment and attract additional countries and foreign companies to seek business opportunities in Russia. This increase in international trade will benefit many parties by bringing in more capital for Russia, creating new jobs, and expanding business opportunities and profits for foreign investors. Russia, in particular, has enormous potential as a profitable market for trade. In St. Petersburg, for example, the Otis Elevator Company began operations for installing elevators in a market that it hopes will generate substantial profits over the next 20 years.¹⁴

Another benefit stemming from increased trade is the added global stability that comes with the integration of successful multinational corporations. Cooperative business ties strengthen a sense of common interest, decrease the risk of aggression between nations, and encourage open debate and peaceful resolution of problems.¹⁵ In addition, democracies make us more secure because they tend not to wage war on each other or sponsor terrorism.¹⁶ In addition, the reduced threat allows the United States to focus attention on other issues, especially problems in the domestic economy.

Finally, by aggressively establishing clear and consistent national economic policies, Russia will establish a framework within which both public and private sectors can operate. In this context, standardized banking practices will encourage both the private and corporate investment whose support is necessary for the growth of a free market economy. This, in turn, will help expand our exports and create American jobs while improving living conditions abroad.¹⁷ Clearly, the successful transformation of Russia into a peaceful, democratic nation capable of participating as a full member of the international community is in the best interests of the United States.

Economic Dimension of Failure. The economic interdependence of the world in the post cold-war international system has moved economic security to the forefront as a vital national interest for many nations. The growth of interdependence brings with it increased vulnerability to the economic actions of other states in the complex international system. These vulnerabilities threaten the welfare and stability of a productive, capitalist society. The United States tends to react negatively to the efforts of rogue states to disrupt the international economy, as evidenced by the decision to fight the Persian Gulf war given the Iraqi threat to petroleum.

The fuel for this complex issue of domestic economics and international politics comes from the concept of the pursuit of personal welfare. As Russia struggles to reform its hundreds of years of autocratic rule and command economies, it could threaten the economic viability of its neighbors, and Europe and Asia most certainly. The potential for reversion to nationalism and irredentism is evident in Russia's actions today. The realization of greater liberty for its people, in the form of property rights and increased personal welfare as capitalism takes root, will further create an environment for greater democratic appeal in Russia.

The success of political and economic reform will create a larger marketplace for Russia's Asian and European neighbors, and further tend to reduce the nationalistic movements in the region calls its "near abroad." Thus the European and Asian economic engines will continue to grow. And through our dependency on their growth and economic prosperity, their markets and our access to them, the United States can inextricably link the success of Russian reform to our national interests. This relationship makes it evident that Russia's success at economic reformation is a vital national interest to the United States.

C. Recommendations for Action

Russia is a significant player on the world stage by virtue of its political, military, technological, and economic potential. The outcome of Russia's experiment with democratic and free-market reform is of immense importance to the United States and the rest

of the world. The primary question thus becomes an operational one — what can the United States do to increase the margin for success in Russian democratic and economic reform?

The United States and the international community need to encourage Russia to move in several broad directions that are consistent with democratic reform. It is an error of historic proportions for the United States to conclude that we have no stake in the outcome of Russian reform, or equally, that we can have a decisive influence on the outcome. As we examine what must be done to promote reform in Russia, it is apparent that outside support will only marginally influence the shape of democracy in Russia.

Develop US Policy Consensus. The debate in the United States about democratic reform in Russia is noteworthy because there is no broad consensus on the aims of our policy. It is evident, from the wavering about the importance of influencing democratic reform in Russia, that the American people and their leaders do not have a clear view of the role of the United States in supporting democratic reform in Russia. And the confusion in US policy is itself a product of the lack of consensus. An axiom of policy in democratic states is that they cannot shape long-term policies without broad support in the society for the policy. As we have seen thus far, the absence of a consensus in the United States on our role in Russian reform leads to shifting and unsteady policies. If we are not clear about our purpose, it is not possible to have coherent and cogent policies over the long term. The implication is not only that the American leadership must define with greater precision why democratic reform is important, but more importantly educate American society about the prospect that reforms will stretch over decades rather than years.

Help Russia Overcome its Non-Democratic Culture. Russia has virtually no historical experience with democracy or with democratic values in politics. The challenge for the United States, and indeed for the rest of the world, is to assist the efforts of the Russian people and policymakers to develop a system of democracy that is appropriate to the unique historical circumstances in Russian politics and culture.

We firmly believe that outsiders cannot do for Russia what Russia needs to do for itself. But there is hope that outside states can play a constructive role in educating Russian policymakers about the strengths and weaknesses of democratic government so that the Russian people can make the best possible choices as they craft a government best suited to meet their own needs. As the Russian people gain an appreciation of democratic values and principles, we must temper our own expectations with the realization that Russians will become impatient with democratic reform as they wait for it to solve their problems. The United States and other states in the West need to help the Russians understand that progress in democratic societies can only be achieved through consensus, and that achieving consensus is often a slow and painful process.

Provide Incentives for Russia to Develop Markets and Trade. There is no more effective strategy to encouraging democratic and economic reform in Russia than for Russia to develop markets and engage in international trade. At the same time, noticeable improvements in the basic standard of living in Russia will go far towards ensuring that reform becomes an enduring feature of politics in Russia. The practical problem, however, is that economic reform is more likely to emerge from within a society than it is to be transplanted successfully from abroad. In the short term, the imperative for the West is to exercise prudence and restraint so that a frenzy of Western economic opportunism — geared largely toward guiding economic development in Russia — does not permanently distort Russia's views about what is required to build democracy and a free-market economy.

Russian Reform is Catalyst to International Security. We conclude by noting that the foremost goal of the United States and indeed of all members of the international community is to foster and promote a peaceful and stable international order. The prospect of international stability would allow the United States, Russia, and the rest of the civilized world to engage in a period of immense and sustained economic growth. For the first time, states might have the opportunity to engage in a constructive dialogue

which resolves a myriad of serious problems, including population control, hunger, disease, and environmental issues. In no small sense, the outcome of the transformation of Russia is a fundamental determinant of whether we shall be able to take advantage of the end of strategic hostility as manifested by the tensions during the cold war. To rephrase the old saw, "as goes Russia so goes the world."

Russian Reform is Vitally Important to United States.

What is not lost on many observers of events in Russia is the simple proposition that democratic reform in Russia is vitally important to the United States. The reason is not the hope that Russia will become a benign actor in international politics, but the realization that for the first time in decades Russia might not be a mortal enemy of the United States. This is a profound difference and one which demands that the United States must remain engaged in Russian reform.

Notes

1. See Secretary Warren Christopher, "Securing US Interests While Supporting Russian Reform," *US Department of State Dispatch*, Vol. 4, No. 13, March 29, 1993, p. 176, for his argument that "helping consolidate democracy in Russia is not a matter of charity but a security concern of the highest order. It is no less important to our well-being than the need to contain a hostile Soviet Union was at an earlier day." (p. 176)

2. See Anthony Lake, "From Containment to Enlargement," *Vital Speeches*, October 15, 1993, p. 15.

3. See Steven Erlanger, "East Europe Watches the Bear, Warily," *New York Times*, October 21, 1994, pp. A1, A6.

4. See Elaine Sciolino, "U.S. Wants to Expedite Entry of East Europe into Alliance," *New York Times*, October 27, 1994, p. A4.

5. See George Melloan, "For Republicans Too Now, the World Intrudes," *Wall Street Journal*, November 28, 1994, p. A19, who argues that a "stronger and more inclusive NATO is the best insurance against a new outbreak of Russian imperialism, some signs of which already have reappeared."

6. See *Nuclear Successor States of the Soviet Union: Nuclear Weapon and Sensitive Export Status Report*, Washington, DC: The Carnegie Endowment for International Peace, December 1994, pp. 39-58.

7. See "Czechs Seize Uranium," *Wall Street Journal*, December 20, 1994, p. A10.

8. See "Russia's Parliament May Balk at START II, CIA Aide Tells Hill," *Washington Post*, March 1, 1995, p. 22, for increasingly uncertainty about the willingness of the Russian parliament to ratify the START II Treaty.

9. A caveat is in order. It is dangerous to view the Chechnya conflict as a barometer of Russian military capabilities, for two reasons. The first is that this was not a well-planned operation, and second this was a conflict that pitted Russian against Russian. As a general rule, we believe it is prudent to assume that Russian forces might perform significantly better if they confronted an external threat.

10. See Jeane J. Kirkpatrick, "A Normal Country in a Normal Time," *The National Interest*, Fall 1990, pp. 40–44.

11. See "Russian Joblessness Understated," *Wall Street Journal*, November 1, 1994, p. A16.

12. While the issue of the impact of increased unemployment is covered in more detail in part II, a survey cited in "Russian Joblessness Understated," *Wall Street Journal*, October 14, 1994, found that joblessness was five times higher than the two percent officially declared. The ramifications of further layoffs could be louder appeals to a more right wing, ultra-nationalist form of government.

13. See *A National Security Strategy of Engagement and Enlargement*, The White House, February 1995, p. 7.

14. Author interview in St. Petersburg, September 1994.

15. See Anthony Lake, "From Containment to Enlargement," speech delivered at Johns Hopkins University, School of Advanced International Studies, Washington, DC, September 21, 1993, for the argument that, "if we can support and help consolidate democratic and market reforms in Russia and the other newly independent states, we can help turn a former threat into a region of valued diplomatic and economic partners."

16. *Ibid.*, for the view that US efforts will increase the likelihood of continued reductions in nuclear arms and compliance with international non-proliferation accords.

17. *Ibid.*, p. 211.

Chapter 3

Toward Democratic Government in Russia

by Katherine E. Roberts

- A. The Problem
 - B. The Current Situation
 - C. Challenges to Democratic Reform
 - D. Recommendations for Action
-

A. The Problem

The relatively peaceful dissolution of Russia's government and economy and their concurrent restructuring is without historical precedent. As a practical matter, we lack compelling historical examples of nations that radically alter their form of government and economy simultaneously without suffering the travails of military defeat or civil war.

Russia's revolution seeks to create a democratic government that reflects the virtues of decentralized political authority and creates a free market economy. To accomplish this, all individuals must be enfranchised with political rights and freedoms. In addition, the Russian people must ensure that their revolution does not sow the seeds of their destruction in a subsequent revolution. At the same time, Russia's revolution must meet the people's need for stability and security in their public and private lives. Finally, the expectations of the Russian people and their leadership must be tempered by the realization that this monumental undertaking will never end. Democracy, after all, is a process, not a state of being.

This chapter examines the current constitutional state of the Russian government with an emphasis on current and potential

problems created by governmental reform. The discussion begins with a review of earlier constitutions, a discussion of the transition from the old order to the new order, and concludes with thoughts on the current constitution. Finally, this chapter addresses several policy recommendations to assist Russian constitutional reform.

B. The Current Situation

Russian society is consumed by the process of managing the transition from the old Marxist-Leninist order to an undefined democratic order in a peaceful fashion.¹ An understanding of Russia's transition to a democratic state begins with Russia's earlier experiences, the subsequent disintegration of the political order, and the emergence of a nascent constitutional order.

1. Dismantling the Old Constitutional Order

Soviet Constitutional Order. The first constitution was adopted in 1924 and subsequently replaced in 1936 at Stalin's behest. Although the fundamental rights differ in many profound respects from those enumerated in the US Constitution, the 1936 Soviet model guaranteed certain civil rights for all Soviet citizens, including the right to work, vote, and receive an education. Despite these rights, the Soviet Constitution did not establish a democratic government.

The Soviet government under the 1936 version did not undergo any substantial changes in the interval between 1936 and 1977, or fundamentally until the revolution in the early 1990s. The national government operated in a hierarchical fashion, and nominally consisted of the executive, legislative, and judicial branches of government. In reality, all power flowed from the Politburo,² the Central Committee, the Secretariat of the Central Committee, and the Communist Party of the Soviet Union. The senior leader of the Soviet Union was the General Secretary of the Soviet Communist Party. Further, the Presidium of the Council of Ministers of the USSR formed the permanent executive organization in the Soviet government.³ The most essential institution in the Soviet government was the Communist Party. It

organized politics within the Soviet Union, and acted as the only legitimate conduit for political power in the society.

While its power was subordinated to the Politburo and Central Committee, the Soviet government did have a legislative branch. Known as the Supreme Soviet, it had the nominal authority to enact laws, admit new Republics or Autonomous Republics and Regions, and endorse the State Budget. The Supreme Soviet consisted of two chambers — Soviet of the Union and Soviet of Nationalities — with equal numbers of deputies and equal legislative rights. Finally, the judicial branch was structured hierarchically under the Supreme Court of the USSR which elected judges and peoples assessors. While the constitution was recognized as the source of all law in the Soviet Union, the system did not enshrine individual rights, but rather acted under the imprimatur of the executive branch of government.

The Gorbachev Catalyst. From the time in 1985 when Mikhail Gorbachev assumed power until the subsequent collapse of the Soviet Union on December 31, 1991, we witnessed the slow transformation of political culture in the former Soviet Union and now Russia. As the first of the younger generation to rise to power, Mr. Gorbachev articulated an outline for political change that ultimately became more radical than even he originally intended. While political and economic reform were the highlights of his political agenda, few thought that we would be discussing democratic and free-market reform in Russia in a serious fashion. As events unfolded, Gorbachev provided the stimulus for a bloodless and peaceful revolution. The agenda shifted to radical reform in a society that enshrined order in totalitarian politics under the headings of *perestroika* ("restructuring") and *glasnost* ("openness").

Stirrings of Democratic Order. The public reaction to *glasnost* and *perestroika*, although muted by Western standards, revealed that Gorbachev had tapped into an incredibly deep well of discontent. Although originally intended to foster economic reform only, *perestroika* quickly expanded to include another area of political reform called *glasnost*. This concept was based on two remarkably familiar themes in democratic government — the

government is accountable to the governed, and there are limits to the power of the government. When Gorbachev openly acknowledged that socialism was not static but had to grow and change, he signaled that Soviet society was poised on the edge of momentous change.⁴

Economic Collapse, Social Discontent, and Democratic Yearnings. For almost 68 years the Soviet Union existed as a totalitarian dictatorship ruled by the ideology of Marxism-Leninism. However, politics in the Soviet Union did not resemble the democratic state that appears to be emerging in Russia in the 1990s. By 1985, it became increasingly clear the Soviet economy was in an advanced state of economic collapse relative to the economic and technological strides of the advanced economies of the West. Even though the secular economic decline in the former Soviet Union was disguised by statistics that showed a growing economy, the reality was that through the vagaries of central economic planning, poor workmanship, and shortages of consumer goods undermined the credibility and health of the regime. In an interesting footnote to history, Soviet intelligence reported in 1985 that the general feeling in governments in the West was that the Soviet Union was an "Upper Volta with missiles," in contrast with the economic productivity possessed by a true superpower.⁵ To emphasize the significance of the economic crisis in the Soviet Union, the KGB reportedly briefed Mr. Gorbachev in 1985 that they did not foresee an end to the economic problems in the Soviet Union.⁶

It is important to note that despite the shackles of totalitarian government, the signs of collapse were visible to the Russian people. Dissent began to grow more vocal, which Boris Yeltsin, when mayor of Moscow, manipulated with great skill in his attacks against the corruption and privilege of the elites. The monolith of a classless society began to crack under the pressure of a state in decay, as average Russians voiced their opposition to the privilege accorded the *nomenklatura*. These fundamental questions about change in political life cannot be swept away. Attempts to do so simply helped the cynicism, always a part of Soviet life, to grow deeper and more pervasive.

The 1991 Coup. While very few Western observers predicted the collapse of communist government and the emergence of popular support for democratic reform, it was equally clear in retrospect that the Soviet Union could not last.⁷ With the gradual dissolution of power and authority in the Soviet Union, conservative forces within the government, including some in the military, launched an abortive coup on August 19, 1991 against President Gorbachev. Although the coup failed, Gorbachev's days were numbered. The true significance of the coup was the outburst of democratic fervor throughout Russia as hundreds of thousands of Russians took to the streets to protest the extra-constitutional act. This was the first public sign that a widespread movement for democratic reform in Russia was ready to express itself after 70 years of communist rule.

Russia's New Constitutional Order. The consequence of the dissolution of the Soviet Union at the end of 1991 was the emergence of the newly independent states along the rim of the former Soviet Union. Of more interest, however, was the acceleration of efforts to launch Russia on the path of democratic and economic reform. In terms of the latter, Russia entered the International Monetary Fund (IMF) organization in 1992 as an observer, thus beginning the long process of privatizing public land and businesses. And with respect to the former, in 1993 the Russian people elected a president, parliament, and approved a new constitution. The voter turnout for such a monumental election was relatively light as only 54 percent of registered voters actually voted. The constitution was approved with a vote of 58 percent, which meant that only 31 percent of the eligible voters in Russia actually voted for the new constitution. Even today, the government continues to struggle to create a broad-based mandate for reform.⁸

The process of drafting the new constitution was laborious and disorganized, but perhaps not unprecedented in view of the enormity of change from a totalitarian to a democratic order. The official process began in the summer of 1993 when President Yeltsin convened the first Constitutional Assembly, whose job was to produce the "final draft" of the constitution. The most significant

issues before the Constitutional Assembly were questions about the power relationship between the Republics and Autonomous Regions to Russia. The Constitutional Assembly voted to support several drafts of the proposed constitution, with each draft sent to the Regions and Republics for review and comment. The final draft was approved by the Russian people on December 12, 1993.

2. Understanding Russia's New Constitution

Russia's new constitution provides the framework within which Russian society is organizing its efforts to implement democratic and free-market reform.⁹ It reorders the fundamental nature of government in Russia and represents a significant step in Russian attempts to create a constitutional government. This section examines the fundamental principles of the constitution, including its transnational provisions,¹⁰ beginning with the three branches of the national government, role of new political parties, results of the national election held in December 1993, and concludes with the rights and responsibilities given to the citizens of Russia.

Executive Branch. The constitution clearly creates an executive branch whose powers are greater than the other branches of government.¹¹ The executive branch is led by a president, who is subject to direct popular election, and who is empowered to appoint a prime minister. The prime minister, in turn, must be confirmed by the State Duma. Below the level of the president and cabinet we find the bureaucracies which exercise control over the daily operation of Russia's national government.

Legislative Branch. The legislative branch of Russia's new government is organized into a bicameral parliament, which is called the Federal Assembly of the Russian Federation. The *Federation Council* is the upper chamber of the legislature and consists of 178 members. Each of the represented regional and local governments has two seats in the chamber, not unlike the arrangement in the United States wherein each state has two seats in the Senate. The method of selection and the term of office, with the exception of the first Council seated under the new constitution, are not defined in the constitution, but are left to be

defined in federal law.¹² The term of office for the first Council is two years.¹³

The Federation Council has broad responsibilities, including the establishment of borders, impeachment of the president, use of the military outside Russia, declaration of a state of emergency, confirmation of the Procurator General and the judges on the top three courts, and the passage of legislation, among other functions. It is interesting to note that the Federation Council and the State Duma have different relationships to the presidency, as exemplified by the fact that while the president can dissolve the State Duma and call for new elections, he cannot dissolve the Federation Council.

The *State Duma* is the lower chamber of the parliament and consists of 450 elected members.¹⁴ The Duma's responsibilities include confirmation of the prime minister and chairman of the State Bank votes of "no confidence," handling impeachment accusations, and the passage of legislation. An interesting constitutional issue is raised when the Duma rejects presidential nominees or issues a "no confidence" vote. In the former case of rejecting a nominee, the president can submit a nominee three times, but if the Duma rejects the nominee all three times, the president may either find a new nominee or may dissolve the Duma and call for new elections. And in the case of votes of "no confidence," the Duma must pass two "no confidence" votes within three months before the president must respond. In that event, the president can dissolve the cabinet and reform the executive branch, or dissolve the Duma and call for new elections. The sole limitation is that the Duma must be seated for at least one year before it can be dissolved.

Judicial Branch. The judicial branch is the weakest and least defined branch of the current government. The weakness of Russia's judicial institutions stems less from vagueness in the new constitution, than to the destruction of the notion of the rule of law in the former Soviet Union. While the new Russian Constitution is quite specific about the independence and the duties of the judicial branch, it has not transcended the political culture of the old order. To be effective, it must establish the foundation for the

rule of law through three principles: courts of law are the only place where justice can be dispensed;¹⁵ the defendant is presumed to be innocent until guilt is proved; and the scope of judicial powers extends over constitutional, civil, administrative, and criminal proceedings.¹⁶

Under the new Russian Constitution, the structure of the federal courts remains the same, consisting of the Constitutional Court, Supreme Court, and Supreme Arbitration Court. In theory, the Constitutional Court resolves issues relative to compliance with enactments and laws specified in the constitution, and also settles disputes between the various bodies of the state and federal authority over jurisdiction and the process of presidential impeachment. On a lesser scale, the Supreme Court is the highest court relative to civil, criminal, administrative, and activities within the jurisdiction of the common pleas courts. The Supreme Arbitration Court has the vaguest area of jurisdiction. Its charter is to "be the highest judicial authority in settling economic and other disputes within the jurisdiction of the courts of arbitration."¹⁷

The legacy of the Soviet judicial system destroyed the concept of jury trials and more profoundly weakened any understanding among the citizens, legal profession, or the judiciary of their roles and responsibilities in jury trials. To complicate matters, existing laws in Russia remain unclear because the Constitutional Court is reticent to issue binding decisions on the contestable points of law. The situation is further confused by President Yeltsin's propensity to issue presidential decrees at a rate that exceeds the ability of the governmental system to assimilate and adopt them. The consequence is that with the great profusion in the number of recent decrees since the adoption of Russia's new constitution, we need to realize that few individuals really understand the state of the law on any given subject. Finally, the perception in Russia is that the laws are not universally enforced, and that laws are enforced only when the aggrieved resort to sub-rosa "transactions" in the system.

The problem, however, is that the judicial branch does not exercise the power consistent with its authority. The greatest shortcoming, which weakens the process of democratic reform,

rests with the still-fledgling role of the Constitutional Court. As of this writing in 1995, it does not play a decisive role in Russian political and legal wrangling, and thus does not weigh into disputes between President Yeltsin and the Duma. The shame is that the struggles between Yeltsin and the parliament need to be moderated by judicial declarations on the powers of the nascent branches of Russia's democratic government. At the very moment of greatest need, the judiciary is unable to respond due to its historical weakness.

3. Signs of Emerging Democratic Behavior

There are signs that Russia is beginning to experience the emergence of democratic political activity, in several ways.

Political Parties and Factions. One of the most essential constituents of a functional democracy is the existence of organized groups which provide a mechanism for like-minded individuals to express their views to the government in order to influence the policies of the state. A remarkable feature of politics in Russia since it became an independent state is the virtual explosion in the number of political parties. An abbreviated sketch of the major national political parties in Russia includes the Agrarian Party, Russia's Choice, the Democratic Party of Russia, Women of Russia, the Communist Party of the Russian Federation, the Liberal Democratic Party of Russia, the Party of Russian Unity and Accord, and the Yavlinsky-Boldyrev-Lukin bloc. In addition, there are five other smaller parties which fielded candidates for the Federal Assembly of the Russian Federation but failed to meet the minimum of 5 percent of votes to be seated in the legislature.

Political parties in a nascent democracy face a number of practical and procedural challenges. One concerns the philosophical role of a political party in a representative democracy. While the answer to this question will be in a state of transition for years if not decades, the current model is similar in many respects to the role of political parties in Western European democracies. A second challenge is the organization of political parties at the local or "grass-roots" level. In contrast to the other

parties, the former Communist Party has a distinct advantage by virtue of its grass-roots representation in virtually every political district throughout Russia. Indeed, the results of the elections in 1993 are probably more reflective of the Communist Party's organizational advantage than a decision by the Russian people to return to communist rule. But that does not reverse the fact that the Communist Party may have greater legitimacy in Russia than it ever had before because they were put in office by free, fair elections.

Russia's Choice. As the parties begin the lengthy process of coalescing into coherent organizations that represent the interests of their constituents, they must define their approach to political and economic reform. Russia's Choice Party, currently the major party espousing reform, garnered support from various smaller political parties. The Russia's Choice platform calls for radical reform in Russian society, establishment of a free-market economy, and privatization of land and selected government assets.¹⁸

Communist Party and Agrarian Party. The Communist Party of the Russian Federation and its ally, the Agrarian Party, are united in a platform that calls for the reestablishment of law and order in Russia. Their political agenda rests on firmly establishing a three branch form of representative democracy based on the rule of law, the creation and maintenance of stability in Russian society, a slower pace of economic and governmental change to promote stability and social adjustment, and the adoption of a new constitution.¹⁹ These political parties express considerable dissatisfaction with the new Russian Constitution largely because its supporters believe that it gives too much power to President Yeltsin and remains too vague about the power and authority of the legislative and judicial branches.²⁰ The only significant area of disagreement between these political parties involves the implementation of land reform.

Liberal Democratic Party. The Liberal Democratic Party (LDP) won large numbers of votes in the last round of elections, and while the LDP did not win a single seat in the Federation Council, it won a surprising 63 seats in the State Duma. The hallmark of the LDP platform is a "Russia first" nationalism that

proposes the cessation of foreign aid and defense conversion, seeks to limit privatization and strengthen the powers of the state, and proposes to enact "special laws" to fight the outbreak in organized crime in Russian society.

Smaller Parties. There are numerous smaller parties that won less than 30 seats each in the last national elections — Women of Russia Party, Yabloko Party, Party of Russian Unity and Accord, and Democratic Party of Russia. The Women of Russia Party is a coalition of three small organizations whose platform focuses on patriotism, the individual, and quality of life issues. The Yabloko Party, also a coalition of three smaller parties, focuses their platform on the need for stability, federal democracy, and "grass roots" reform. The Party of Russian Unity and Accord wants to preserve Russia above all else, but also addresses the need to restore the "rule of law," equality, human rights, and the establishment of a stable economy. Of these parties, the smallest to clear the 5 percent hurdle is the Democratic Party of Russia. Its primary platform plank is to establish a federal democracy in Russia, limit the powers of the president, create economic efficiency through fundamental economic reform, restrict the sale of land, and build a stronger Commonwealth of Independent States.²¹

4. Russia's Constitutional Problems

The Constitution, which defines opportunities and constraints within which society will operate, is the foundation upon which Russia will build a democratic society — if it succeeds. However, Russia's Constitution does not provide the same opportunities that are available in other democratic societies. Thus, there are several problems that impede Russia's efforts to promote democratic reform.

Presidential Domination of Politics. Although the new constitution was jointly drafted by the executive branch and the legislative branch, the executive branch clearly dominates the process. The new constitution is fairly specific in granting broad powers to the president, much like the French system, but the powers granted to the legislative and judicial branches are

relatively vague and inchoate. In addition to the power to dissolve the State Duma, the president possesses other broad powers, such as the ability to rule by decree.

The predictable result of Russia's constitutional politics is that there will be years of vociferous and discordant debates among the three branches of the national government and between the national and regional governments. Nor is this an unexpected development, for we in the United States still see, after over two hundred years of constitutional rule, constant struggles among the three branches of the federal government as well as between the federal government and the states. The two areas that generate the most antipathy in Russian politics are the use of presidential decrees to amend or create laws and the role of presidential envoys. As a general principle, Russia must develop a more routine form of government, for declaratory decrees do not advance democratic reform.

Legislative Indecision and Paralysis. The record of the legislature in Russia can charitably be described as inefficient. The norm in the Duma during the last several years is writhing and fractious debates between ideologically-polarized political parties that do not produce solutions to pressing social and economic problems in Russia.²² But the parliamentary sessions are more than simply disputes among contending political parties and factions. They represent disagreements that involve differences about the fundamental issues in Russia, including whether and how to guide Russia through the travails of government and social reform. The consequence of these frictions is a legislature that is seen by the Russian people to be weakened by indecision and paralysis.

Unclear Rights, Inchoate Judicial System. As Russia proceeds, fitfully it often seems, to institutionalize democratic reform, the extent and strength of individual rights remains unclear. As typified by the weakness of the Constitutional Court, Russia cannot make significant progress toward a democratic government and free-market economy until several problems with the judiciary are resolved and the rule of law is established.

Vague Notion of Property Rights. The Russian Constitution articulates the right to own property as one of the fundamental issues of the new political order. In reality, however, the notion of property rights is in the earliest stage of development. One of the complications is the wholesale distribution of government property to former communist officials in practices best described as questionable. Still, the notion of private property is fundamental in a democratic society, and one which is not well developed in Russia.

Radical Versus Incremental Reform. Russia is trapped in a debate about the pace and magnitude of political and economic reform. For some factions, it is imperative for Russia to disassemble all vestiges of the communist order and to recreate in their stead an entirely new political culture in Russia. For other factions, the imperative is precisely the opposite, namely that the very soul and existence of Russia are threatened by democratic and free-market reform, as evidenced by the disintegration of all elements of civic life in Russian society. For these observers, the threat to Russia is not the old order, but the removal of an order without institutions and norms to replace their predecessors and in whose absence social chaos is the inevitable product.

Thus, we see the emergence of two distinctly different perspectives on the nature of democratic reform, and hence a wide and growing gulf on the basic issues that define the rationale for political and economic reform. It is difficult to fathom just how Russia is to proceed on the course of fundamental change when there is no consensus in society on the direction in which change ought to occur. To be fair, however, Russia benefits from a political climate which accepts that it cannot simply return to the past, as the crowds in August 1991 as well as April and October 1993, vividly demonstrated. The risks for Russia of the debate between radical and incremental reform are magnified by the challenges of not only restructuring its government and economy, but learning to compete with the rest of the world in the global economy. One might argue that the search for perfect unanimity in Russia contributes to governmental paralysis.

Observers in the West believe the success of political and economic reform depends on coordinated efforts among all sectors of Russian society and government. Whereas the United States and other societies implemented radical reforms well before the emergence of the modern industrial state, Russia has no such luxury. It must implement democratic reform while simultaneously building a market economy and privatizing the assets of an entire state.

Synergism of Political and Economic Reform. Economic and political reform must be pursued in tandem if the goal is to establish a democracy. Because democracies require market economies, there are few historical examples of successful democracies that operate on the basis of a command economy. Interestingly, however, the reverse is not true, for authoritarian regimes may experiment to varying degrees with market economies.

Toward this end, there are several elements of the new constitution which impede the establishment of a market economy in Russia. An interesting example is Article 24, which requires the consent of the individual to gather, store, use, or disseminate information concerning the private life of the individual. If the information directly affects the rights and freedoms of the individual, then it may be used for official purposes only. This restriction directly affects the marketing and advertising strategies of companies that sell consumer information. Another example is Article 13, which holds all public association equal before the law, with the exception of those advocating forceful overthrow, creating armed units, or inciting social, racial, ethnic, or religious strife. In effect, this article needs to be clarified by federal legislation or the courts. Is the development of new manufacturing technologies, which cost people their jobs, a form of "inciting social strife"? Thus, the broad point is that constitutional provisions act as impediments to economic reform in Russia.

C. Challenges to Democratic Reform

As the process of democratic reform continues in Russia, we must understand that Russia faces several challenges that relate

directly to building a democratic society in the place of a totalitarian state.²³

Building a "Democratic Culture." The success of democratic reform in Russia hinges ultimately on the ability to construct a new political culture that embraces democratic ways of conducting public and private affairs. One component of political culture is the attitude of the people toward government. For now, it is fair to say that the Russian people demonstrate equal mixes of hostility, docility, and contentedness with their government. But the challenge is for the government to act in ways that encourage the people to believe that the government is working in their interest. The actions of President Yeltsin and the Duma, unfortunately, confuse the nature of federal power-sharing, and thereby weaken the process of building the foundations for the legitimacy of the Russian government. Thus, the Russian people and leadership must articulate a compact which expresses the legitimacy of the emerging democratic system, but also strive to codify the accepted rules of how a democracy operates in Russia.

It is evident that the fundamental relationships between individuals and the government are ambiguous at best. The fact that less than one year passed since Russia adopted a new constitution explains in part why there is no clear sense in Russian politics of the balance between individual rights and state prerogatives. And yet when we consider its totalitarian past, this is the most elementary of conditions that are necessary for the establishment of democracy in Russia. On one level, the Russian people and their representatives must engage in a debate about balance between the rights of the individual and those of the state. All states that aspire to be democratic must wrestle with the conundrum of rights. Russia, too, must come to grips with the balance of power and authority between the individual and the organs of state power. Until these relationships acquire a greater degree of clarity in Russia, we can safely presume that democratic reform in Russia will not move as decisively or expeditiously as it otherwise might.

Fragmentation of Russia. Arguably the most critical threat to the success of Russian political and economic reform is the

question of the unity and integrity of Russia itself. The nature of political, social, economic, and ethnic unrest within Russia inevitably raises the risk of centrifugal forces pulling Russia apart, perhaps in the form of a civil war. Events in Chechnya are themselves a portent of the risks inherent in societal fragmentation. For a society in the midst of the massive changes that are occurring in Russia today, unity among some 140 different cultures may be impossible to maintain within a society that represents diverse cultures and historic rivalries.

Given the prospect that Russia might face challenges in maintaining unity, one can envisage several scenarios of Russian fragmentation. One prospect is that various ethnic areas within Russia begin to declare their independence, as seen in Chechen-Ingushetia and Moldova, leading to guerrilla movements, escalation by the Russian government with troops, and attempts to exercise tighter control — all which adds fuel to the revolt. The failure to implement meaningful economic reform and the subsequent risk of hyperinflation and social chaos poses another threat to Russian unity during this time of reform.

Military Impediments to Reform. A further challenge to democratic reform in Russia involves the role of the military. The question is whether the Russian military will adhere to its historical pattern of remaining on the sidelines during times of civilian crises. Unfortunately, it is far from clear whether historical precedence will be followed given the prevailing consensus among Russian military officers that social and economic decay adds to the instability of Russian society. There are, however, only anecdotal reports on the patience of the military with the current situation. As one officer said, “we will wait for now for the civilians to establish a stable economy and a stable government, but we will not wait forever.”²⁴ Nor are military officers sanguine about allowing Russia’s ability to defend itself to deteriorate. When asked about the availability of supplies, particularly food, to support the military, the response from an officer was, “an army with weapons will never go hungry.”²⁵ The single greatest impediment to directing military action is the lack of a unified vision. It is unclear whether Russian troops

will respond to orders, and if they do not, Russia might face civil war.

Turmoil in the Near Abroad. Yet another source of potential challenges to democratic reform is the continuing state of unrest in the near abroad. The danger is that the disintegration of states in the near abroad, or simply their accelerating attempts to distance themselves, provokes Russia to forcibly reintegrate these regions. One consequence is to reinforce the predisposition of the more extremist elements within Russian society to act aggressively to reassert the power of Russia. The point is not to open the debate whether the West or these states ought to recoil from assertive action because Russia might react, but to underline the point that regional instability does not strengthen the positive forces for change.

Popular Anxiety About Reform. Russian citizens view the future with a combination of trepidation and resignation. As yet, there is no sense that the Russian people have a clear sense of the existence of any realistic alternatives, despite the clear consensus that Russia cannot go back to the old order. These feelings constitute the greatest source of dissatisfaction in Russia, and provide the fuel for instability.

D. Recommendations for Action

Given the challenge of democratic reform in Russia, it is easy for the Russian people and their leaders to be overwhelmed. While Russia cannot instantly create a stable and prosperous government and society, it is important for the Russian people to sense that progress is being made. The following recommendations involve small, incremental steps, and are offered in the spirit of highlighting the more important steps that Russia must make to ease the transition to a democracy.

OBJECTIVE: Strengthen Democratic Governance in Russia. There are many steps that Russia must take to strengthen democracy in Russia. In this section, we focus on the broader strategies that Russia must consider rather than the more tactical measures.

Recommendation 1: Elevate the “Rule of Law.” Russia must establish a political philosophy that elevates the “rule of law” above all else if the government is to be seen as legitimate and deserving of support. To establish a judicial system, Russia must build a legal system in which the behavior of all individuals and institutions conforms to the letter of the law. Only then can Russia establish a system of laws that confer legitimacy. It is essential that the “rule of law” involves all political officials, beginning most prominently with the highest governmental officials. The notion of legal limits must be visible to all of the people. For example, when President Yeltsin and the Duma engage in political struggles, those occasions in which they ignore court rulings serve to undermine the legitimacy of the government and, more broadly, further weaken democratic reform. Likewise, the actions of the Duma, which itself seems to be mired in confusion and struggle, do not inspire the confidence of the Russian people.

The fundamental point is that the Russian people must have faith in the rule of law. If they do not believe that the rule of law matters, or that their elected officials are willing to obey the law, Russia faces perhaps the most serious and potentially fatal impediment to political and economic reform. One symptom of Russia’s struggle to establish the rule of law is the great emphasis that the people place on individuals in the government rather than on the governmental process. When the institutions of government are so new, the tendency is to place confidence in individuals because the people have little experience in the political process.

Recommendation 2: Accelerate Legal Reform. It is evident that many of Russia’s current laws are inconsistent with the notion of governmental and economic reform. Nor is this surprising given the seventy-year legacy of communism and its effect on the legal system in Russia. But now that the Russian people approved the new constitution in the December 12, 1993 referendum, it is the responsibility of the Russian leadership to accelerate legal reform. One area involves the creation of federal legislation, as required by the constitution, for the purpose of establishing laws governing behavior in virtually all sectors of the

society. This includes laws governing elections, finances, crime, and so forth. Another area is to ensure that all existing laws are consistent with the spirit of the new constitution. Russia will find that many of the laws on the books are no longer appropriate, and thus need to be rescinded or amended as quickly as possible. Until Russia tackles this fundamental problem, it will not have a body of law that establishes a solid legal foundation for all public and private activity in the society.

Recommendation 3: Clarify "Separation of Powers, Checks and Balances." Because Russia has chosen to move in the direction of a democratic government consisting of three branches of power, the current chaos in the Russian government illustrates the need for clearly delineated powers and responsibilities among the officials and their respective institutions. If Russia continues to proceed along the path of separate branches of government, democratic reform will succeed only as the political leadership shares power among competing institutions. For now, the political process in Russia is best described as a struggle between individuals who do not adhere to constitutionally mandated limits on their power. A corollary is that, if the Russian people and their leaders continue along the current path of reform, the natural competition between individuals and institutions must be balanced by a creative tension between the national, regional, and local governments.

Recommendation 4: Provide Technical Assistance. The tendency for Americans is to offer political theory, and while this may be useful on some scale, the area in which we can provide the most benefit to Russia is technical assistance. What Russia needs is less in the way of political treatises, and more technical assistance. Specifically, the United States can assist Russia over the next several decades with the development of laws and institutions that manage economic issues in a free-market economy. Because the Russian people are not familiar with the workings of a market economy, they have not yet learned to appreciate the finer points of governance, particularly in terms of

the economic implications of legislation. This is particularly important when dealing with legislation in the areas of tax reform and the social safety net. In this particular situation, the United States can be quite helpful by acting as a source for information and expertise. Exchanges of personnel between businesses in Russia and the United States, training courses, consultants, and many other resources are available to the Russian's if they choose to take advantage of them.

Notes

1. See Michael McFaul, "Russian Politics: The Calm Before the Storm?," *Current History*, October 1994, pp. 313–19.
2. The name "Politburo" was changed to the "Presidium of the Central Committee" on the eve of the death of Stalin at the 19th Party Congress. Mr. Brezhnev changed the name back to the "Politburo" in 1966, and he changed the post-Stalinist title of "First Secretary of the Communist Party" back to its original title of "General Secretary of the Communist Party."
3. See Daniel C. Diller, *Russia and the Independent States*, Washington, DC: Congressional Quarterly, Inc., 1993, pp. 429–431.
4. See Mikhail Gorbachev, *Perestroika*, New York: Harper & Row, Publishers, 1987, p. 44, for his comment that, "... improving socialism is not a spontaneous process, but a job requiring tremendous attention, a truthful and unbiased analysis of problems, and a resolute rejection of anything outdated ... half-hearted measures will not work here... One more conclusion — the most important one I would say — is that we should rely on the initiative and creativity of the masses; on the active participation of the widest sections of the population in the implementation of the reforms planned; that is, on democratization and again democratization."
5. See Christopher Andrew and Oleg Gordievsky, *KGB: The Inside Story*, New York: HarperCollins Publishers, 1986, p. 607.
6. *Ibid.*, p. 608.
7. See Charles Wolf, Jr., "The Fine Art of the False Alarm," *Wall Street Journal*, November 1, 1994, p. A20, for thoughts on the general failure in the West to predict the progress of economic reform in Russia.
8. See Vladimir V. Belyakov and Walter J. Raymond, (eds.), *Constitution of the Russian Federation*, Brunswick Publishing Corporation and Novosti, 1994, p. 15.
9. See Carla Thorson, "Russia's Draft Constitution," *RFE/RL Research Report*, Vol. 2, No. 48, December 3, 1994, pp. 9–15.

10. *Ibid.* The use of the term "transnational" in the title of Part Two is at odds with the rest of the constitution, which is based on the idea that the only sovereign entity in the Russian Federation is the Russian Federation. Lower levels of government are not considered sovereign. However, Part Two deals with the precedence of the constitution relative to state documents and treaties between the federal government and the various forms of state governments (regions, autonomous regions, areas, republics, and so forth). An additional note of interest is the title of the treaty on the delimitation of powers between the national government and the republics. The full title is "Treaty on the Delimitation of Jurisdiction and Powers between the Federal Bodies of State Authority of the Russian Federation and the Bodies of State Authority of the Sovereign Republics within the Russian Federation."

11. See Alexander Rahr, "The Russian Leadership: Changes in the Executive Branch," *RFE/RL Research Report*, Vol. 3, No. 7, February 18, 1994, pp. 8-10.

12. *Ibid.*, p. 54.

13. *Ibid.*, p. 77.

14. See "Fact Sheet: Russia," *US Department of State Dispatch*, June 6, 1994, Vol. 5, No. 23, pp. 366-71, which states that 225 of these representatives are elected directly by the people and 225 are chosen from party ballots as is the practice in Western Europe. However, the Russian Embassy in Washington insists that all 450 representatives are elected directly by the people. As it is with the Federation Council, the constitution is silent about the method of electing the State Duma, but leaves the matter to be defined by federal law. The constitution does, however, specify the term of office as four years, with the exception of the first Duma seated under this new constitution, for which the term of office is two years.

15. See Belyakov and Raymond, p. 66.

16. *Ibid.*, p. 32.

17. *Ibid.*

18. See Steve Liesman, "Yeltsin's Decree On Privatization Leaves Foreigners Wary of Investing in Moscow," *Wall Street Journal*, February 24, 1995, p. A5b, for the difficulties of privatization in Moscow.

19. See Yevgeni Grishin, "Who's Who in the Russian Parliament," *Russian Life*, Winter/January-March 1994, pp. 6-9.

20. See Igor Konstantinov, "Russian Citizens on the December 12 Election Results," *Russian Life*, Winter/January-March 1994, p. 10.

21. See Grishin, pp. 6-9.

22. See Wendy Slater, "Russian Duma Sidelines Extremist Politicians," *RFE/RL Research Report*, Vol. 3, No. 7, February 18, 1994, pp. 5–9.

23. See Vera Tolz, "Problems in Building Democratic Institutions in Russian," *RFE/RL Research Report*, Vol. 3, No. 9, March 4, 1994, pp. 1–7.

24. Author interview in Moscow, September 1994.

25. *Ibid.*

Chapter 4

Toward Democratic Government in Ukraine

by David A. Hafele

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- A. The Problem
 - B. The Current Situation
 - C. Decisive Forces in Ukrainian Politics
 - D. Recommendations for Action
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A. The Problem

Since the breakup of the Soviet Union in August 1991, Ukraine evolved from monolithic communism to a nascent democratic state. This evolution, now in its fourth year, is fraught with challenges that are directly spawned by the protracted period of Soviet domination, the proliferation of new political parties, the emergence of ethnic, religious, and geographic diversity, and still-pregnant uncertainties about Ukraine's national leadership. But the struggle continues, as we still observe that there is no current legal foundation for government or a relevant body of law. The interim institutions of government are primitive and ineffective, and the process for adopting an acceptable form of government is unclear and chaotic.

Ukraine is engaged in an experiment with democratic government whose outcome cannot be known. In this chapter, we examine the current state of democratic reform in Ukraine. The purpose is to consider the nature of Ukraine's transition from its declaration of independence to the foundations of a durable and functional nation-state which is governed by the rule of law.

B. The Current Situation

Signs of Independence. Until 1991, the government of Ukraine was dominated by Russia for hundreds of years, and more recently by the Soviet Union. But with the accession of Mikhail Gorbachev to the leadership of the Soviet Union in 1985, we witnessed the unraveling of political, social, military and economic stability. The reforms that Gorbachev advocated under the concept of *perestroika* (restructuring), while unevenly embraced and often considered radical in Russia, were seldom implemented in Ukraine, despite the avowed support of the First Secretary of the Communist Party of Ukraine (CPU).¹ Ukrainian dissidents and reform groups continued to follow the restructuring process in the Soviet Union, but witnessed little in the way of corresponding reforms in their homeland. Supported by the Ukrainian peoples' negative reaction to the secrecy surrounding the Chernobyl accident, and amidst growing discontent with housing, working conditions and food supplies in the mining and industrial sectors, Ukrainian dissidents gained strength in their opposition to the existing government leadership. The catalytic moment came in November 1988 with the founding of the Ukrainian People's Movement for Restructuring (RUKH), and the subsequent publication of a manifesto and establishment of branches throughout the republic to provide an organization for resistance.

The failure of the Government to control the growing influence of RUKH and to cope with worker unrest in 1989 led to unprecedented support for a coalition of RUKH and other independent candidates seeking legislative seats. As a result, in the Spring 1990 elections opposition parties won almost 40 percent of the seats in the Ukrainian Supreme Soviet (legislature), with the balance retained by the Communist Party of Ukraine (CPU). This event was the catalyst for reform because in a very short time, the significant shift in both the mood and political balance in the legislature propelled Ukraine toward reform of the government and leadership, and ultimately down the path to independence. In July 1990, Ukraine's Supreme Soviet adopted a declaration of sovereignty and proclaimed the supremacy of republican authority in the territory of the Republic. And soon thereafter, Leonid M.

Kravchuk was appointed the new Chairman of the Supreme Soviet, the highest position in the republic.

In the face of increasing dissatisfaction among the Ukrainian people with the progress of *perestroika* in the Republic, the main political objective of the opposition slowly evolved from seeking state sovereignty within the context of a reformed USSR to the complete independence of Ukraine. Meanwhile, within the CPU, there were signs of growing differences between the so-called National Communists, led by Leonid Kravchuk, who supported moves towards more independence, and the Imperial Communists, who remained committed to the current relationship with the USSR.² Events in Moscow broke the balance between these contending groups in 1991.

The failure of the State Committee for the State of Emergency to assume power in Moscow on August 19, 1991 set the stage for Ukraine's independence. Barely a week later, on August 24, Ukraine's Supreme Soviet adopted a declaration of independence and scheduled a direct presidential election. Finally, on December 1, with an overwhelming 90 percent majority vote, the Declaration was confirmed by a referendum and Kravchuk, based on his experience and support for Ukrainian independence, was elected president.³

In the span of barely 18 months, Ukraine made the radical shift from absolute domination by the central communist government of the Soviet Union to complete independence as a sovereign state. In the past, strong and capable leadership was not essential in Ukraine because Moscow made the important decisions. Ukraine now had to assume responsibility for its affairs with a new president, government, and radically different political landscape.

Building Democratic Governance. From the beginning, Ukraine's new president and parliament proceeded to design a government that reflected Western experiences with democratic governance. The hope was to build a society with democratic institutions, and thus move beyond a fragile state of independence to a robust and stable political system. But we cannot understate the difficulties inherent in this revolution.

In the decades prior to independence, Ukraine functioned under a Soviet style constitution that mandated a clearly subordinate relationship with Moscow. The emergence of independence, however, unleashed forces in Ukraine which recognized that the first priority was the creation of a new constitution. We cannot forget that Ukraine faces political and economic challenges of truly daunting proportions. Thus, rather than designing a new constitution, Ukraine's new government decided to modify the existing constitution with approximately 500 changes and the issuance of thousands of decrees. The predictable outcome was that several years after independence, Ukraine is still governed by the Soviet-era constitution. Which has been modified so many times that many aspects of the law are blurred.⁴ By May 1994, Ukraine's government showed many signs of ineptitude, attributable to rapid change and an inability to control the inherited apparatus of the state. Ukraine moved haltingly toward a new government order with its adoption of a parliamentary democracy with three separate branches: executive, legislative, and judicial.⁵

Executive Branch. The executive is made up of a President elected for a five year term, and a Chairman of the Cabinet, known as the Prime Minister, who is appointed by the President. Also appointed is the First Deputy of the Cabinet, known as the Deputy Prime Minister, who oversee 24 ministers or cabinet members. As currently structured, the Prime Minister and the cabinet are subordinate to and directly accountable to the President.

Ukraine's government includes 24 regional governments headed by regional leaders that are appointed by the President, as well as the Kiev Capitol District and the Crimea Republic. The function of these regional governments is to manage the affairs of the local governments throughout Ukraine.⁶ The problem is that the regional governments fall under dual legislative and executive leadership. The effect is to create mixed and often conflicting guidance, thus weakening the accountability of the central government and producing a government often mired in bureaucratic gridlock. In more political terms, the division of power is hopelessly confused — to the extent that the power of the

constituent parts of Ukraine's government can be determined. As Ukraine's first president, Leonid Kravchuk observed, "we have no structure of executive power which can implement policies. The result is that everybody works in the old way, which means their aim is to escape responsibility."⁷ A fact that further compounds Kiev's problems is that even after three years of independence the central government remains tiny, with 12,400 employees to govern Ukraine's 52 million people.⁸

Legislative Branch. Formerly the Supreme Soviet and currently styled the Supreme Council, Ukraine's legislature—the Rada—consists of a one chamber body with 450 deputies directly elected by the people for four-year terms. Leadership of the body is exercised by a chairman, deputy chairman, secretariat, and committee chairmen.

Judicial Branch. In theory, the judicial branch of Ukraine's government is designed to be an independent source of power and authority in Ukrainian society. The court system consists of a Constitutional Court which has national jurisdiction;⁹ General Courts which operate at three levels: oblast (land or regional) appellate courts, inter-rayon (district) courts, and rayon (city or local) courts. Judicial oversight of the activity of the general courts is performed by the Supreme Court.¹⁰ Finally, the judicial arm of the Ukrainian Armed Forces consists of a system of military tribunals within the system of general courts as well as a system of tribunals to resolve economic disputes.

C. Decisive Forces in Ukrainian Politics

There are several important forces that shape the outcome of democratic reform in Ukraine.

Nationalism, Geography, and Political Parties. The complexity of politics in Ukraine is best understood by the use of the simplifying "four-four" rule. In essence, politics in Ukraine revolves around four geographic regions and four political groups. Those geographic regions are distinguished by a combination of linguistic background, history of domination by Russia and later

the Soviet Union, and the degree of political involvement of the peasantry.

The western regions of Ukraine are overwhelmingly Ukrainian-speaking and remained apart from Russia until it fell under Soviet domination in 1939. At the same time, the peasant population was heavily involved in a struggle for national liberation during World War II and have since retained a high degree of national identity. In a similar vein, Central Ukraine is dominated by Ukrainian-speaking peoples, but suffered immense deprivation and often annihilation at the hands of the Soviets when the peasantry was decimated during collectivization and the subsequent famine in the 1930s. The result, perhaps not surprising, was to diminish the nationalistic spirit of the people. Eastern Ukraine is predominantly Russian-speaking, and evidences a high degree of urbanization and a heavy concentration of industries. As a region, it tends to lean toward Russia. Finally, the South, including Crimea, consists of a mostly Russian-speaking population that is concentrated in the cities and a politically-inactive peasant population.¹¹

Political Parties. As we might expect, the myriad of political parties reflects this amalgam of geography and nationalism. The political landscape in Ukraine is dominated by approximately 30 political parties that coalesce into four main groups on the basis of their attitudes toward economic reform, government reform, and relations with Russia. Whereas the Leftists prefer the prior regime of control by communists and are pro-Russian, the Liberals postulate that deteriorating conditions in Ukraine's economy are the product of inadequate attempts to implement privatization, land reform, and tighter fiscal and monetary policies. The Liberals tend to draw support from the more industrialized areas of the East, and accordingly are inclined to favor closer relations with Russia. The National Democrats share similar views on domestic economic reform with the Liberals, but differ due to their strong opposition to the Russophilic orientation of the Liberals. Finally, the Radical Nationalists represent politics as a struggle between ethnic Ukrainians and the Russians who are the instrument of Ukraine's earlier bouts of political, cultural, and economic

oppression. However, many observers believe that the most influential political faction in Ukraine may be the loosely called "Party of Power," which draws its support from governmental officials within the office of the president, ministries, parliament, and regional governments.¹²

The consequence of the profusion of political parties and factions is that with Ukraine's recent ascent to independence, there is no practical consensus among political parties on the issues facing the state. In the absence of an apparent mandate from the people that translates into political support for Ukraine's popularly-elected government officials, it is difficult for Ukrainian political leaders to find common ground among the disparate political cultures in Ukraine. On a positive note, Ukraine's second president, President Kuchma who was elected in July 1994, built his candidacy on selected elements taken from many parties. This strategy suggests that pluralism is beginning to emerge in Ukraine's politics.

Building Democratic Leadership. In the Soviet era, the fundamental purpose of the government ministries in Kiev was essentially to respond to orders from Moscow.¹³ Because Ukraine was important to Soviet power — due to its geographic size equivalent to France, third largest nuclear arsenal in the world, second largest conventional army in Europe, strategic location on the Black Sea, and agricultural and industrial might — it was important for the Soviets to exercise tighter control than that exercised over other Republics. In the old order, the Soviet leadership understood that without Ukraine, the Soviet empire would cease to exist. Thus, to maintain control, the Soviet leadership made a concerted effort to suppress the development of an autonomous leadership in Ukraine.

First Independent President is Weak. We begin with the proposition that the first elected President since Ukraine gained independence was a relatively weak one. It is useful to outline the evolution of this first presidency.

On December 1, 1991, following the Declaration of Independence by the Ukrainian Supreme Soviet, Leonid M. Kravchuk was elected as the first President of an independent

Ukraine. Despite his past record as a loyal communist official, Kravchuk's recent experience and support of independence ensured his election.¹⁴ Winning with 62 percent of the votes, Kravchuk was aided by an opposition divided among numerous political factions which were unable to create a candidate with broad-based political appeal and support.

However, Kravchuk's many years of experience in the political and legislative side of Ukrainian government shaped him into a consummate politician with strong skills in building a consensus, but a relatively weak leader in terms of articulating a broad strategic vision. One view of Kravchuk's leadership strategy was to shield himself from attacks and criticism by working through the Prime Minister and with the Parliament while building a consensus on governmental and economic reform. But the inescapable reality was that Kravchuk's leadership continually depended on consensus because he was not the leader of any particular political faction. His political capital grew in proportion as the Communist Party's monopoly on political life decayed. As his role as the initiator of dialogue and compromise between the majority and the opposition also weakened, he simultaneously distanced himself from the official Communist Party line. The paradox is that Kravchuk won the presidency by being an advocate of compromise from the still dominant party.¹⁵

Kravchuk showed from the beginning that he preferred to lead by integrating individual policies rather than being on the cutting edge of policy formation. The presumption was that the fragmented nature of the political parties, coupled with their weakness and limited political influence, weakened the ability of the individual political parties to support controversial policies. The political climate did not place a premium on innovative policies with their attendant political risks. The norm for President Kravchuk was to adopt the least risky policies, often by taking the course of least risk of embracing and then integrating policies developed, introduced, and supported by others.

A characteristic of Kravchuk's leadership style was his tendency to introduce legislative proposals rather than detailed legislation. Some argued that legislative proposals rather than

detailed legislation symbolized Kravchuk's weak commitment to a specific political agenda. Kravchuk's lack of detailed legislative initiatives weakened the executive, and allowed the principle of government responsibility to be vested in the legislature, which basically left the formulation of policy unchanged from the day prior to Ukraine's independence.¹⁶

In speeches and interviews, Kravchuk often emphasized the need to retain existing legislation, even though many in Ukraine believed that fundamental change was in order. Kravchuk's long history of association with the Communist Party was apparent in his cautious and conservative approach to reform.¹⁷ A common criticism of Kravchuk was that as President he displayed little initiative and rarely availed himself of his constitutional rights as chief executive to influence the legislative process. Limits on the legislative initiatives of the Parliament were imposed for the first time in November 1992, when the Parliament granted special powers to the Prime Minister, rather than the President, to implement free-market reform and an economic stabilization program. Kravchuk's signature on this law constituted an act of self-disengagement from one of the main functions of the executive branch — regulation of Ukraine's economy.¹⁸ And yet in Kravchuk's March 1994 visit to Washington, the first by a leader of independent Ukraine and ostensibly to sell his vision of Ukraine's role in the world and the need for US assistance, to the surprise of the Clinton Administration, Kravchuk's silence about his vision was almost deafening. It seemed he had none.¹⁹

The hallmark of Kravchuk's skills was his ability to operate as a politician who built a consensus on policy, rather than as a visionary leader for reform. His principal leadership strategy was to delegate responsibility and authority for all matters, including the formulation of strategy and policy, to his subordinates or to the legislature. Ultimately, Kravchuk's refusal to stand at the head of the government, his weak and distant leadership style, and his inability to articulate a strategy or vision for democratic reform in Ukraine precipitated the end of his presidency in July 1994.

Governance Under President Kuchma. On July 10, 1994, Leonid D. Kuchma defeated Kravchuk to become the second President since Ukraine gained independence in 1991. With 52 percent of the vote, Kuchma's election was seen as a popular affirmation of the need for dramatic change after Kravchuk's ineffective leadership style during the preceding three years.²⁰ Kuchma, the son of a farmer from the central region, spent his life in the industrial side of the party. Starting from the factory floor, he moved up in the technical arena to work in the Baikonur Space Center, became the general director of the Dnipropetrovsk Rocket Factory, and finally achieved the position of Technical Director of the largest Soviet Arms Production Complex in Ukraine. In 1992, he was appointed by Kravchuk to be Prime Minister.

Kuchma became President at a propitious moment that required dramatic action. The disintegration of Ukraine's economy was apparent to Ukrainians and to members of the international financial markets alike — inflation running at 40 percent per month, a budget deficit equal to 44 percent of GDP, and real total GDP declining at a rate of 18 percent per year.²¹ The survival of Ukraine depended, Kuchma argued, on the election of a president who exercised strong executive leadership in economic reform, coordinated outside assistance, and acted as an effective communicator of Ukraine's dire situation, while building a political fabric that rests on unity of purpose and nationalism.

Kuchma argued that Ukraine in particular needs strong executive leadership in economic reform, to be organized in a two-phase strategy. The first phase is to convince the Rada and the people that Ukraine cannot survive without a strong executive whose governance is based on clear lines of authority, for only then will it be possible to implement broad political and economic reform. These sentiments were evident in President Kuchma's inauguration speech on July 19, 1994.²² In that speech, he described, "a single executive vertical structure as the fundamental instrument of implementing statewide policy."²³ In the second phase of reform, implemented on August 10, 1994, Kuchma extended his own authority by issuing numerous economic and non-economic decrees that gave him effective control

over government policy. His actions appear to have mitigated the bureaucratic gridlock that dominated politics during the Kravchuk administration.

To increase the incentives of states to provide assistance, the second phase of Kuchma's two-track strategy as to maintain studied ambiguity in Ukraine's geopolitical orientation while pursuing economic reform.²⁴ Recent reports suggest that countries which are interested in Ukraine as a political and economic partner, notably states in Central Europe, Russia, Japan, and the United States, are interested in how Ukraine will align itself in political and economic terms.²⁵ During the period of studied ambiguity, the incentive for outside states to invest in Ukraine or provide assistance was the promise of serious economic reform. Kuchma's strategy is to walk the fine line between making strategic commitments yet demonstrating enough sympathy for the strategic concerns of other states. Thus, when we hear frequent comments about the prospect of an economic union with Russia, Kuchma's representatives comment that because the rest of the world is largely indifferent to Ukraine's fate and Ukraine is dependent on Russia for scarce resources, Ukraine may be forced to maintain its historic relationship with Russia.²⁶

Kuchma's strategy is to be honest and direct with the Ukrainian people on what needs to be done, the pain implicit in reform, and the fact that Ukraine has no alternatives to broad reform — as far as practical politics permit. His approach is to maintain high public visibility and reinforce the point that Ukraine needs strong executive leadership. The hope, one surmises, is to build popular support for the very difficult reforms set forth by his decrees, while giving the people hope that reform will improve their position. Thus, Kuchma is attempting to build national unity in a state where ethnic, geographic, and political diversity complicate the desire to achieve some semblance of national unity in politics.

Governance Amidst Economic Disintegration. The emphasis in Ukraine's leadership is to shift from strategic questions about the transition to a market economy and the adoption of a new constitution, to the resolution of Ukraine's

steadily worsening economic crisis. Inflation was 4,735 percent in 1993 and roughly 842 percent in 1994.²⁷ In November 1994, inflation leaped to 72 percent — up from 22 percent in October — after price controls were removed.²⁸ In the first quarter of 1994, a tightening of the money supply reduced monthly inflation from 80-90 percent in December 1993 to 40 percent in the summer of 1994, but this caused the annual rate of decline in the gross domestic product to accelerate to 36 percent and unemployment to soar to 40 percent.²⁹ For all practical purposes, Ukraine is mired in the stagflation of a shrinking economy and high inflation.³⁰

With its economy virtually in a state of free fall, Ukraine's government seeks to apply immediate short-term fixes. For example, Ukraine experienced its worst energy crisis in late 1994 since independence.³¹ The problem is the absence of a leadership that provides strategic guidance to Ukraine in this moment of crisis. In the case of the Rada, it is so polarized among competing political factions that it is difficult to reach a consensus on what must be done. There is a mounting struggle between President Kuchma and the Rada over the degree of privatization.³² Furthermore, there remain profound doubts about the wisdom of Kuchma's economic rapprochement with Russia, despite the lure that closer economic relations with Russia will provide the financial and trading benefits that Ukraine desperately needs. Nor can we forget that rapprochement with Russia is a source of agitation among the Ukrainian nationalists who remain fearful of weakening the independence of Ukraine.

Despite these conflicting political pressures and economic realities, Kuchma is now working to promote free-market economic reform in the belief that the economy must rule politics — rather than the converse — and that Ukraine needs to secure economic assistance from the developed world. Kuchma, a proponent of economic reform, eliminated price controls, removed subsidies, abolished export quotas, and suspended a fixed exchange rate.³³ The thrust of a \$4.1 billion assistance package by the G-7 nations is designed to reduce subsidies to industry and agriculture.

No Clear Constitutional Order. One of the key problems with Ukraine's democratic reform is the lack of a modern constitution that outlines the responsibilities and authority of the government, and the lack of a legitimate body of law that provides the foundation for the political and judicial system. The consequence of an amorphous legal framework is the resort on the part of the legislature and the executive to use decrees and edicts as a solution to governmental gridlock. So many decrees were issued, one often contradicting another, that few can articulate the law of state or the government's policy. To make matters worse, not only is the President issuing decrees, but so too are the Parliament, the Prime Minister, and individual cabinet ministers. Effective control within government is lost as competing institutions struggle to assert their power over one another institutions. Without a functional constitution, decrees have the power to change the fundamental structure of government within an environment where literally only the strong may survive. Kuchma does have the legitimacy of being directly elected by the population, but in the relative legal vacuum of the transitional period, the actual spheres of jurisdiction among government institutions are blurred and in a state of constant flux.

Conclusions. In less than three years Ukraine experienced not only a radical change in governance but two presidents who operate with varying leadership styles and strategies. On the economic front, Ukraine will continue to struggle with the collapse of its economy. Both political and economic challenges will determine Ukraine's success in democratic reform. Ukraine demonstrated that the destruction of the old government and its subsequent reorganization will not immediately create a democratic civil society. And it may be true that attempts to rapidly impose a free market economy may have the opposite effect. Democracy grows from the bottom up and cannot be imposed or mandated from the top. Civil society must be built from the inside out with the institutional superstructure coming last. It will take decades for Ukraine to become a democratic state, and for their thinking about democratic governance to mature. In the meantime, governance in Ukraine remains chaotic, but this is

normal for a society whose governmental institutions do not yet serve the demands of a emerging democratic state.

D. Recommendations for Action

There are several recommendations that we can offer as Ukraine moves toward democratic governance and as the United States contemplates how it can best influence that process.

OBJECTIVE 1: Strengthen Rule of Law. The most important objective for Ukraine is to establish a government that is based on a durable body of laws. This must reflect a consensus among the Ukrainian people on a governmental structure that is consistent with their democratic ideals.

Recommendation 1: Accelerate Efforts to Build a New Constitution. Ukraine must focus its efforts on establishing the new constitution as the fundamental arbiter of politics. More specifically, Ukraine's government must review the composition of the Constitutional Commission and give representation to all three branches of the interim government. Further, as Ukraine drafts new legislation and refines existing legislation, it must adopt through a popular referendum a new constitution in order to create a balance among all branches of government. It is clear today that the Draft Constitution does not achieve this objective. More immediately, Ukraine must achieve a consensus on the type of government that the Ukrainian people want — including the current options of a democratic social state, democratic capitalist state, or socialist state — and translate that agreement into Ukraine's constitution.

Recommendation 2: Rule by Legislation not Decrees and Regulations. The norm in Ukraine today is to rule by decree. The President rules by decrees and executive branch agencies rule by regulations. The political process in Ukraine directly contrasts with the practice in democratic states in which political bodies build a consensus to support the passage and implementation of

legislation. If Ukraine wants to establish a more normal process of governance, all political institutions must stop using decrees and regulations as the instruments of policy.

Recommendation 3: Accelerate Economic Reform.

Fundamentally, Ukraine cannot engage in democratic reform unless it maintains some degree of economic order. A stable economy is one of the strongest guarantees that Ukraine will survive as a sovereign state. It is advisable for Ukraine to use economic reform to secure economic assistance from the West, as exemplified by the promise of the G-7 nations to provide \$4 billion in aid if Ukraine maintains its efforts to reform the society and economy. Additionally, the fact that many of Ukraine's neighbors are moving toward market economies and democratic institutions suggests that Ukraine's most promising future may lie in economic reform and economic integration with its neighbors in Eastern Europe.

Recommendation 4: Pursue Geopolitical Neutrality.

There are a number of countries interested in assisting Ukraine, for reasons that include economic or political self-interest and regional or international stability. The safest course for Ukraine is to demonstrate its independence by continuing to maintain a stance of geopolitical aloofness. Ukraine needs to focus on establishing the basic institutions of an independent state, such as a limited military, economic control of borders, and state symbols, while exercising care if it involves itself in formal political, economic, or military unions. To cite one example, Ukraine demonstrated the merits of caution when it refused to sign a charter pledging closer political and economic integration with the CIS. While Ukraine denied that this refusal implied its withdrawal from the CIS, this policy demonstrated that Ukraine fears Russian attempts to resurrect the controls that exercised during the Soviet era.

Recommendation 5: Strengthen Relations with G-7 and Europe. Ukraine's current economic difficulties are traced to the legacy of the command economy that existed under Soviet domination. The industrialized nations in the West can help

Ukraine develop a free market economy and assist Ukraine as it rebuilds its economy. Ukraine realizes that the enormous financial and technical resources of the International Monetary Fund and the West are critical to the success of economic reform. In January 1994, President Clinton invited Ukraine to participate fully in the Partnership for Peace, which can promote economic and military cooperation between NATO and Ukraine. The United States and Ukraine further agreed to expand economic ties in order to support economic reform. In this vein, the United States unilaterally established an enterprise fund to help Ukraine capitalize small businesses and assist existing firms with privatization.

OBJECTIVE 2: Influence Evolution of Democratic Governance in Ukraine. The Clinton Administration declared that the United States has an interest in seeing Ukraine transform itself into an independent democratic state. A hallmark of Clinton Administration policy is to link the dismantlement of Ukraine's nuclear weapons to political and economic support from the United States.

Recommendation 1: Provide Technical and Economic Assistance. The most reliable guarantee of political and economic stability in Eastern Europe is the maintenance of an independent Ukraine free from Russian domination. It is equally true that the greatest threat to Ukraine at present is the collapse of its economy. If Ukraine's economy deteriorates into chaos, Russia will find it easier to exert pressure on Ukraine to bend it to the Russian will. Thus, the United States and the West need to accelerate their support for economic reform in Ukraine, largely through the provision of technical assistance. For the same reasons articulated in Chapter 8, the answer does not lie in greater financial assistance to Ukraine, but in the provision of specialized advice that helps Ukraine rebuild the institutions that regulate a modern free-market economy.

Recommendation 2: Establish An Organization To Coordinate US Assistance to Ukraine. The most practical and

efficient way to deliver technical and economic assistance to Ukraine is through one agency which has representatives in both Ukraine and the United States. For now, the United States uses a panoply of agencies to coordinate assistance, which effectively weakens oversight and control of assistance.

Recommendation 3: Separate Economic Assistance and Denuclearization. We believe that it is not advisable for the United States to link economic assistance to Ukraine to nuclear dismantlement. The United States will be better served by a policy that emphasizes Ukraine's importance to Eurasian stability, rather than implying that all we care about is Ukraine's nuclear weapons. Because economic and military security are separate phenomena, the United States needs to focus its policy first on building economic security in Ukraine, while addressing military security issues at a later time. Parenthetically, an economically secure Ukraine is more likely to believe that nuclear weapons are not essential to its security.

At the same time, however, the United States cannot be inattentive to Russia's interests. Since the collapse of the Soviet Union, Russia is concerned about what it sees as NATO encroachments. There is no doubt that Ukraine and the border states are of historic importance to Russia. The border states are historically important to Russia in economic terms and provide a strategic buffer for Russia. Given that one of the Russia's objectives is to contain NATO, the United States must proceed with caution. The rapid incorporation of Ukraine into NATO could inflame relations with Russia. While the United States cannot acquiesce to this Russian demand — despite the fact that we seem to give Russia a veto on NATO policies — the United States must prevent Russia from containing NATO.

Notes

1. See "Ukraine: Introductory Survey," *Europa World Year Book*, Vol. II, 1993, p. 2881.

2. *Ibid.*, p. 2882.

3. See "Fact Sheet: Ukraine," *US Department of State Dispatch*, May 2, 1994, p. 269.

4. See Andrew Cowley, "Ukraine, The Birth and Possible Death of a Country," *The Economist*, May 7, 1994, p. 4.

5. *Ibid.*, p. 8. As President Kravchuk admitted, "We (Ukraine) were part of the Soviet Union and have had to create a state from scratch."

6. See *US Department of State Dispatch*, p. 269.

7. See *The Economist*, p. 8.

8. *Ibid.*

9. See "Concept of Judicial, Legal Reform," *FBIS-USR-92-121*, September 24, 1992, p. 101, for background on the Constitutional Court, which is composed of a chairman, two deputy chairmen, and 12 members, and are elected (secret ballot) by the Supreme Council for 10 years without possibility of reelection.

10. The Supreme Court judges are also elected by the Supreme Council, while lower general court judges are appointed by the President. See "Law on Constitutional Court," *FBIS-USR-92-121*, September 24, 1992, p. 105; "Concept of Judicial, Legal Reform," *FBIS-USR-92-121*, September 24, 1992, p. 101.

11. See Dominique Areal and Andrew Wilson, "The Ukrainian Parliamentary Elections," *Radio Free Europe / Radio Liberty*, July 1, 1994, p. 6.

12. *Ibid.*, p. 7.

13. See *The Economist*, p. 8.

14. Prior to this, Kravchuk held numerous positions within the CPU and Legislature including the Party's Ideology Chief, Second Secretary of the CPU, and finally Chairman of the Supreme Soviet.

15. See Igor Markov, "The Role of the President in the Ukrainian Political System," *Radio Free Europe / Radio Liberty*, December 3, 1993, p. 32.

16. *Ibid.*, pp. 33-35. We now see that the majority of the laws and resolutions adopted by the Parliament stemmed from its own initiative, including those political decisions that were directly within the competence of the Executive Branch — above all, the President. According to one observer in *Radio Free Europe*, under Kravchuk the Ukrainian Presidency has become a constitutional addendum to the Parliament rather than an attribute of the Executive Branch.

17. See *The Economist*, p. 9, for reports that at one point President Kravchuk commented that you don't wake up one morning and stop believing, which indicated an evolving commitment to the principles of reform.

18. See Markov, p. 33.

19. See *The Economist*, May 7, 1994, p. 4.

20. See Steven Erlanger, "Ukrainians Elect A New President," *New York Times*, July 12, 1994, p. A5.

21. See "Ukraine: Man of Iron," *The Economist*, December 26, 1992–January 8, 1993, p. 62, and "Change at Last," *The Economist*, November 21, 1992, p. 62.

22. See "Kuchma Gives Inauguration Speech," *FBIS-SOV-94-139*, July 20, 1994, p. 35, for his view that "people have placed the responsibility for conducting reforms on the single entire system of executive power headed by the President. I...intend to persist with this aspiration and to use fully the powers given to me to conduct such reforms."

23. *Ibid.*, p. 36.

24. See "Gore Visiting Kiev, Pledges Support for Economic Change," *New York Times*, August 3, 1994, p. 10.

25. Once Ukraine's strategic orientation is clear, those countries which are not critical to Ukraine may terminate assistance, which obviously would be to the detriment of Ukraine. A further complication is that early identification of a specific interest in the United States or Russia is bound to create frictions with Ukraine's nationalists.

26. See *The Economist*, May 7, 1994, p. 10.

27. See Jane Perlez, "Ukraine Gets Reformer at the Helm," *New York Times*, November 29, 1994, p. A9.

28. See "Ukraine's Inflation Rate Jumps," *Wall Street Journal*, December 13, 1994, p. A14.

29. See Dominique Areal and Andrew Wilson, "Ukraine under Kuchma: Back to 'Eurasia'?", *RFE/RL Research Report*, August 19, 1994, p. 6.

30. During a visit to Kiev in September 1994, the exchange rate for Ukraine's coupon in US dollars changed on September 23 from approximately 4,000 coupons to the dollar to 6,000 to the dollar — a sure sign of the return of hyperinflation.

31. See "Blackouts in Ukraine," *Wall Street Journal*, December 30, 1994, p. A4.

32. See "A Showdown is Seen Over Ukraine Reforms," *Wall Street Journal*, December 12, 1994, p. A11.

33. See Natalia A. Feduschak, "Ukraine's President, Set to Meet Clinton, Finally Can Point to Some Progress," *Wall Street Journal*, November 21, 1994, p. A10; Peter Passell, "Economic Scene," *New York Times*, November 24, 1994, p. C2, for reports that economic reform in Ukraine is moving in a positive direction.

Appendix on Ukraine's Draft Constitution

This appendix examines the critical elements of Ukraine's Draft Constitution in order to provide insights into the debates that are shaping Ukraine's nascent efforts to create a democratic state.

Formulation. Guided by the Concept of the Constitution approved on June 19, 1991 and the Declaration of Independence approved on December 1, 1991, Ukraine set out to establish the legal foundation and fundamental law for the independent government by drafting a completely new constitution. The first draft constitution was completed in March 1992 and subsequently revised in July 1992, with the most recent draft of October 26, 1993 currently under consideration.

Approval Ambiguities. While the government of Ukraine consists of three branches, the responsibility for formulating the articles of the constitution and drafting the document resides primarily in the Constitutional Commission of the Supreme Council and its working groups which operate under a chairman — who is also Chairman of the Supreme Council of the Rada — and a co-chairman (the President). When constitutional proposals and comments are adopted into the draft document, these are submitted to members of the Supreme Council for consideration and debate. It is important to note, however, that it is unclear exactly who approves the constitution and how the approval process operates. While it is normal for the legislature to enact changes to the constitution, the authority of the legislature to approve a totally new constitution is not established. Furthermore, since the Soviet era constitution, which still exists, placed primary power in the hands of the Communist Party in the Supreme Soviet, this arrangement is not relevant to Ukraine's political dynamic.

The approval question is further compounded by the fact that the draft constitution appears to favor a strong legislature and ceremonial president. Given this imbalance in institutional

powers, it is not prudent to allow the Rada to legislate its position of strength. Surely the legislature is willing to become the repository of the authority for approving the constitution. In opening the May 3, 1993 session of the Constitutional Commission, President Kravchuk cautioned that the new constitution should not be adopted. He also warned against raising the issue because the present Ukrainian Parliament will never agree to adopt such a constitution. He was alluding to the frictions among Ukraine's various political parties that are not united in their positions on nationalism, ties to Russia, or Ukraine's strategic position in the world. And if Ukraine is unable to achieve consensus, Kravchuk argued that even a special constitutional assembly might have troubles adopting a new constitution. His recommendation was for the Rada to adopt two or three laws and thereby avoid the paralysis of a situation in which Ukraine cannot circumvent a stalemate in the Rada.¹

The dominant political parties stressed the need to convene a specially convened constitutional assembly in order to adopt a new basic law. These parties have enlisted the help of other political factions which share their views about a constitutional assembly. The proponents also supported the formation of a national constitutional committee consisting of representatives of all parties whose function is to formulate a consensus by which the President and the Supreme Council can approve the constitution.² The obvious shortcoming is that leadership committees rarely produce timely and substantive results, thus further delaying the creation of an effective government in Ukraine.

One of the more acceptable ways to pass a new constitution is through the process of a nation-wide referendum, but this involves decisions about the mechanism for gaining the concurrence of the Rada. Furthermore, attempts to eliminate the more egregious inconsistencies in the text of the fundamental law are likely to create an impasse in Ukraine, given the fractious state of political parties in Ukraine.

Concept of the Constitution and Draft Constitution. Due to the significance of the debate at various meetings of the Constitutional Commission, there is an interesting relationship

between the Concept of the Constitution (June 19, 1991) and the current draft constitution (October 26, 1993). First, we must understand that the "Concept" only defined the basic principles of the future constitution. Second, the rapid changes in Ukrainian politics affect societal attitudes toward the constitution. There are several important differences.

(1) Structure of the Parliament. The "Concept" provided for a unicameral parliament, while the commission in 1992 supported arguments for a bicameral (two chamber) parliament. The early drafts of the constitution reflected the bicameral structure, but the most recent draft of October 26, 1993 reverted to a unicameral structure. On this point, the leader of one of the working groups observed that in the majority of the world's democratic countries with stable legal systems, the bicameral structure of parliament provides the most efficient legislative process.³ His view was that if Ukraine embarks on the path of local and regional self-government, the parliament needs to represent the interests of the self-governing territories, thereby leaving the question of a one- versus two-chamber parliament unresolved.

(2) Office of the Vice President. The "Concept" provided for the office of Vice President, but when enacting the law on the President of July 5, 1991, two weeks after the concept was approved, the Rada voted against introduction of this office, and the office was not carried forward in the current draft of the constitution.⁴

(3) Term Limit of Judges. The "Concept" proposed the establishment of a term limits for all judges of 10 years, and for the judges of city and rayon courts to be elected by the people. While the concept of judicial and legal reform was approved, the legislature approved a procedure for appointing the judges of rayon courts by the President. But it granted the legislature the authority to elect the judges of oblast courts and the Supreme Court for unlimited terms — with the exception of judges appointed to the office for the first time. The issues of term limits and the authority to appoint judges are currently being debated.⁵

(4) State Executive Power. In connection with the formation of a new system of state executive power, and local and regional

self-government, the legislature, enacting the law *On the Representatives of the President of Ukraine* and the new version of the law *On the Local Soviets of People's Deputies and Local and Regional Self-Government*, departed from the fundamental propositions of separate national and local governments that were contained in the concept of the new constitution. The legislature voted in favor of a system of local self-government through peoples deputies operating at all levels of the republic. Furthermore, the highest official on the territory of an oblast, rayon, city, community, and village Soviet is the chairman of the corresponding Soviet of Peoples Deputies, who is simultaneously the chairman of the executive committee and the authorized representative of the President. The "Concept" of the constitution influences the local governments, both in terms of local authority and local self-government. But the legislature essentially minimized the role of separate national and local authorities when this concept was not carried forward in the current draft of the constitution.⁶

Framework. The draft of the new constitution reflects the changes that have occurred in the social life of the Ukrainian people and outlines the prospects of the state's further development. The draft emanates from the 1991 Concept of the Constitution, as well as underlying legal principles, which formed the basis of the laws enacted by the legislature following its approval of the conceptual principles of the new constitution. In framing the document, the Constitutional Commission drew on the expertise of leading specialists in the field of constitutional problems from the United States, France, Germany, and Hungary. On the whole, the draft is consistent with international standards of constitution building and the most important international human rights documents.⁷

Primacy of Individual Rights. The principal theme in Ukraine's Draft Constitution is to establish the individual as the principal object of legal protection by guaranteeing that the rights and liberties of individuals are of the highest importance. More than any other feature, this principal provides the fundamental point of departure from the earlier constitutions in

the Soviet era, and distinguishes itself from previous constitutions that elevated the role of state and party interests above that of the individual. The Draft Constitution articulates legal and social mechanisms whose sole purpose is to protect individual rights and liberties. The Draft Constitution begins with the argument that the primary role and purpose of the state is to serve the individual and civil society by defining laws which seek to be the guarantor of equal opportunities for all citizens. To accomplish this, the Draft Constitution recognizes the importance of protecting individual rights and freedoms.

The Draft Constitution defines Ukraine as a democratic, social state based on the rule of law. The Draft Constitution extends the idea of popular sovereignty in which the sole source of state power is the citizens of Ukraine, while emphasizing that no one national group, political party, organization, or individual may seize the right to exercise state power.

The draft divides state power into executive, legislative, and judicial authorities. Provision is made also for balances to prevent individuals or groups from usurping power and using it contrary to the interests of the people. Ukraine is attempting to build a state based not on the principle of unity of power in the hands of the state, but on laws that share state power among three equal branches. While the Draft Constitution creates a presidential republic as the form of state government, it retains elements of a parliamentary-presidential form of government. This is evident given the extraordinarily wide range of powers granted to the Parliament, including supervision of the executive. But if an important concern is to divide functions among the state structures to create equally independent, strong, and efficient institutions, the draft did not achieve this goal.

An additional feature is the attempt to convert the national character of the local Soviets of Peoples Deputies into local and regional self-government, reduce their role in state functions, and concentrate their efforts on the interests of the local constituents. A corollary is to concentrate executive power and authority at the regional level. Finally, the draft deals with whether the President heads the ministerial cabinet directly. The Constitutional

Commission decided, and hence its decision is reflected in the Draft Constitution, that the President is the head of state and head of the executive but does not chair the cabinet — although the President exercises general leadership of the cabinet. Subordinate to the President will be a Prime Minister who will head the cabinet of ministers.

Principles of Ukraine's Constitutional Order. To begin with, the constitution is based on the principle of emphasizing that the state exists to serve the individual rather than the state. All sections of the draft emphasize that the state will preserve the rights of the individual, the conditions of free self-expression of each individual, and the priority of values common to all mankind. The draft also seeks to create a civil society that preserves equal opportunities for the free development of diverse forms of ownership, enterprise, and social and political organizations. The draft also encourages the spiritual revival of the Ukrainian people, the provision of social safeguards for the least protected elements of society, and guarantees to protect the environment. Finally, the draft reinforces the notion of a civil society which prohibits the state from exploiting its own people by ensuring that the state remains under the control of the electorate to serve their needs.

At the same time, the Draft Constitution builds a democratic foundation for politics which is based on a separation of state power into executive, legislative, and judicial power. The Draft Constitution portrays Ukraine as a sovereign, independent, and democratic state that operates on the basis of the rule of law. The aspiration of Ukraine's leadership is to become a full member of the international community without the undue influence of Russia.

Finally, the draft is the result of a unique moment in which Ukraine is not experiencing the travails of a class struggle or revolution, but is benefiting from a period of relative peace and civil harmony. This arrangement in Ukraine is all the more peculiar given that its history was shaped by external influences that led to major changes in governmental structure and political orientation through violent revolution and bloodshed. If Ukraine

survives the turmoil of building a democratic government, it may redefine the art of the possible in political upheaval.

Notes

1. "Debates Process of Adopting Constitution," *FBIS-SOV-93-084*, May 4, 1993, p. 42.

2. "Parties Hold Talks on Possible New Constitution," *FBIS-SOV-93-091*, May 13, 1993, p. 42.

3. See "Kravchuk Speech on Draft Constitution," *FBIS-USR-92-093*, July 24, 1992, p. 82.

4. *Ibid.*

5. *Ibid.*

6. *Ibid.*

7. *Ibid.*, p. 81.

Part II

Democratic Reform of Economy and Society

Chapter 5

Impediments to Free-Market Economy in Russia

by Brian R. Badger & Charles E. Byrd

- A. The Problem
 - B. Russia Lacks Framework for Free-Market Economy
 - C. Disintegration of Russian Economy
 - D. Impediments to Reform
 - E. Recommendations for Action
-

A. The Problem

Four hundred years of Russian history produced a national culture dominated by oppressive governmental practices that stifled the establishment of a free-market economy. As the Russians toiled for centuries under some form of feudal command economy, their culture and government instilled the view that such economies are superior, while the free market is essentially lawless and chaotic. The power of criminal groups in Russia and the conspicuous influence of the rising entrepreneurial class only reinforce Russian prejudices and suspicions. The upheaval is complicated by the lack of social, political, and judicial constraints, as well as the inherent historical bias of the Russian people against free markets. We believe, however, that while the problems facing the Russian people today are monumental, they can be overcome with time and perseverance.

Russia's effort to build a free-market economy is emerging from these ruins. The essential problem for Russia is the continued existence of their historic economic system. Although they lost the cold war, they did not suffer the physical destruction of their economic system. Now they must totally rebuild, while facing the

daunting problem of an embedded command economy that cannot simply disappear. The Soviet command economy did not use market forces to determine what to produce, who should produce it, how much to produce, or what to charge. The Soviet command economy provided all of the basic needs of the individual, including social welfare requirements. In this ultimate welfare state,¹ the individual gained job security, guaranteed income, housing, and other necessities. The consequence, however, was the destruction of initiative, productivity, and quality that are hallmarks of free-market economies.

The reality is that the nature of Russia's current economic disintegration and malaise is firmly entrenched in Russia's peculiar economic history. Before we can grasp the economic barriers facing the Russian people today, we must reflect on Russia's economic experiences from Tsarist times to the present move to reform the Russian economy.² Thus, in this chapter we address the magnitude of the evolution of the Russian economy, beginning with Peter the Great and proceeding to reform under Gorbachev and ending with the current state of the Russian economy under Yeltsin. Finally, the chapter concludes with recommendations to strengthen the process of economic reform in Russian society.

B. Russia Lacks Framework for Free-Market Economy

As this section elaborates, the themes in Russia's economic development are precisely opposite of those that are needed now to build a free-market economy.

Russia's Industrial Revolution. The reign of Peter the Great in the seventeenth century coincided with the existence of an oriental-style, agrarian, and feudal society with little industrial capacity.³ Dominated by the nobility, large landholders, and the Orthodox Church, Russia did not participate in the industrial modernization in Europe, and thus was economically backward compared to the rest of Europe.⁴ As Peter began to westernize Russia by improving the educational and economic systems and vastly increasing the industrial capacity, he also increased the national tax burden and simultaneously stifled any private

attempts at economic improvement for the purpose of financing these reforms. The response of the serfs and peasants was to establish an underground or black market economy to improve their standard of living. While not new in Russian history, this secondary, albeit clandestine, economic system became an integral part of the Russian society. Despite the turmoil, Peter transformed Russia from an isolated feudal society into a leading European power during the first quarter of the eighteenth century.⁵

The Russian economy remained little changed until the reign of Alexander II. By that time, Russia's emerging industrial capability required a more skilled labor force than serfdom provided. The effects of rising dissatisfaction among the serfs, increasing requirements for skilled labor, and the inability of the landholders to adequately provide for the serfs forced Alexander, in 1861, to free over 40 million peasants.⁶ This, on the surface, sounds like a major advance for the serfs and an improvement in the economy, but the lack of any legal or cultural framework for decentralized economic behavior inhibited Russia's entry into the industrial revolution.

Bolshevik Economics. Despite several attempts at reform, the Russian economy remained backward in comparison with the rest of Europe. While the industrial revolution finally reached Russia, its success was constrained by disintegrative forces within the agricultural community, as increased taxes, government controlled prices, and severe weather caused famine and peasant unrest.⁷ In this economic and political climate, Russia was ripe for a civil war. The catalyst was provided by the Bolsheviks who, preaching to a disillusioned working class, ignited the spark that started the "Third Russian Revolution," or what we know today as the October Revolution of 1917.⁸

War Communism Established Command Economy. The Bolsheviks instituted draconian measures to recover Russia's failing economy from the devastation of World War I and the fighting during the ongoing civil war. V.I. Lenin established "War Communism" in 1918–1921 to improve the deteriorating economic situation. War Communism ultimately destroyed the existing market exchange system by printing trillions of rubles in worthless

paper money, resulting in hyperinflation.⁹ War Communism, while otherwise a failure, firmly established the Bolsheviks in power and gave the Russians their first glimpse of a command economy. However, Russia had neither the governmental structure nor the experience to efficiently administer this system.

New Economic Policy. Social unrest and economic stagnation forced Lenin to change tactics. He introduced the New Economic Policy (NEP) in 1921, which aimed to combine a market economy with socialism by nationalizing only heavy industries, transportation, banking, and foreign trade. Agriculture was allowed to fluctuate with market influences, rewarding success and penalizing failure.¹⁰ The significance of the NEP was the establishment of a pseudo-market economy where entrepreneurs were allowed to prosper in a decentralized economic environment.

Stalin's Economic "Reforms." Joseph Stalin believed that the NEP violated the tenets of dialectic materialism, and accordingly instituted economic shock treatments to return to the true path of the communist utopia envisioned by Karl Marx.¹¹ As Stalin consolidated his power within the Soviet Union, he enacted the first of the Five Year Plans for economic advancement in 1928.¹² The first Five Year Plan (1928–1933) established the shape of the Russian economy until the reforms that were begun by Mikhail Gorbachev. The hope was that the collectivization of agriculture would free large numbers of peasants to develop other parts of the Soviet economy. Consumer goods were considered detrimental to the establishment of the communist utopia, because they consumed valuable resources, raw material, and labor. The oppressive environment established by Stalin's paranoia, the Great Depression of the nineteen thirties, the Great Patriotic War (World War II), and the onset of the cold war forced the Soviet economy to concentrate on heavy industry and defense at the expense of consumer products and the peoples' standard of living.

Economic Stagnation. While this legacy continued throughout the next eleven Five Year Plans, the economic situation in the Soviet Union improved only slightly from year to year — and was dismal in comparison with the improvements

made by the world's market-based economies. The generation of leaders in the post-Stalin era was never satisfied with the performance of their economy, as efforts were made each year to refine the plan in the hope of improving quality, efficiency, innovation, and customer responsiveness.¹³

Khrushchev's Early Reform Efforts. There were five major reform programs and many economic experiments prior to Gorbachev's "perestroika." Although Nikita Khrushchev continued Stalin's command economy, he experimented with innovative programs in an attempt to improve the Soviet standard of living.¹⁴ In 1957, he tried to decentralize the economy by empowering newly established regional governmental councils designed to eliminate the "departmentalization" of the long-established ministerial planning system (*Gosplan*). These councils evaluated the economy within their regions and attempted to increase efficiency by either shifting or discontinuing production. A bonus system was instituted that paid workers incentives when gross output exceeded target quotas.¹⁵ In 1950, Khrushchev attempted to improve agriculture by instituting a land reform program that opened up 100 million acres of unimproved land for collective cultivation in Central Asia and Siberia.¹⁶ While these programs alleviated some of the short-term problems, they did not overcome the inherent difficulties and deficiencies of the command economy.

Brezhnev's Reform Attempts. The reign of Leonid Brezhnev coincided with rapid economic decline. In an effort to arrest the slide, he reinstated the former Gosplan system and attempted, largely unsuccessfully, to improve the economy. The 1965 reforms encompassed three major changes — administrative restructuring back to the ministerial system, complete overhaul of the incentive system, and major industrial price reform — but these reforms provided only temporary economic gains for an economy still crippled by inherent inefficiencies. Additional attempts at reform in 1973 and 1979 had little tangible effect upon an economy that continued to deteriorate rapidly.¹⁷ The result was an economic system in the advanced stages of decay, unable to reverse the

impending collapse, much less maintain the output of the Soviet economy of the Stalin era.

Precursor of Economic Reform. Iurii Andropov inherited an economy on the brink of collapse.¹⁸ He was frightened by the advanced state of economic deterioration, and feared that without radical restructuring Russia could not compete technologically with the West, or even hope to meet the increasing demands of its citizens. The Andropov “experiment” gave five selected ministries more autonomy to develop and produce goods in accordance with consumer demand. The hope was that linking worker and management compensation to economic performance would stabilize those industries. In addition, major tax incentive programs were instituted to reward successful enterprises in an experiment that involved over 700 enterprises. It is likely that Mikhail Gorbachev, who was gaining prominence under Andropov, played a major role in implementing these proposals. While these reforms were not coherent, and many enterprises found it difficult to meet the new expectations, the Andropov experiment was a partial success because it enabled selected ministries to increase productivity.¹⁹ The short and turgid reign of Konstantin Chernenko which followed produced no serious reform.²⁰

You Say You Want A (Economic) Revolution. The monolithic structure of the Soviet economy — with its bureaucratic rigidity, ideological contradictions, and social impotency — was ripe for revolution. Gorbachev’s confirmation as party chairman and the subsequent institution of “perestroika” and “glasnost” unleashed the inevitable but unexpected “Second Russian Revolution.” The reigns of Gorbachev and Boris Yeltsin marked the beginning of Russia’s experiment with free-market reform.

C. Disintegration of Russian Economy

As we review the history of Soviet economic development, it is important to focus on several factors that illustrate the economic crisis that Russia faces today.

Secular Economic Decline. The conditions which sparked “perestroika” signaled that the acute stagnation of the Soviet era

had crippled technological and economic progress on all fronts. More importantly, the Soviet Union was competing with states which possessed much higher standards of living. The relative decline in the lifestyle of the Soviet people was evident during the period of glasnost, as the flow of information to the Russian people increased their awareness of living standards outside Russia. They saw the differences in lifestyles and personal freedoms between themselves and their western neighbors. By any measure, the quality of most of its manufactured goods was far below the standard of industrialized states. Also, large grain imports continued to be necessary as the lack of a transportation and distribution infrastructure left whole harvests rotting in the fields.²¹ But perhaps more important was the accelerating development of advanced technologies in the West. The gap between the Soviet Union and the rest of the world in all areas of technology highlighted the inferiority of the Soviet system.

Gorbachev's Market Reforms. The first genuine step on Russia's road to free-market reform began when Gorbachev proposed a "systematized program" and "concrete strategy" at the conference of the CPSU Central Committee in June 1985.²² What made this first step politically possible was the realization that the Soviet economy was in chaotic decline. The reality was that economic decline had been in progress for as long as 20 years, perhaps beginning with Stalin's forced industrialization.²³ Gorbachev's political genius was his ability to transform the malaise in the Soviet economy into "new thinking" to revitalize the Soviet economy. Because the government was so deeply intertwined with the economy, there was no real restructuring of the Soviet economy because there were no corresponding reform of the government bureaucracy. While these initial steps were tentative, they represented the beginnings of the destruction of the command economy. The program proposed by Gorbachev and the subsequent events in Russia changed forever the fundamental economic complexion of Russia.

Economic Reform Without Clear Strategy. Much of the evidence suggests that Gorbachev introduced his economic reforms without a clear or systematic plan for implementation,

reflecting the reality that the government and economy were deeply intertwined, as well as the need to mollify those in the leadership. With his declaration that economic improvement was his most important goal, he accepted the post of General Secretary of the Communist Party and set the stage for economic reform in the 1990s.²⁴ The purpose was to introduce market-oriented demand and to improve the economic well-being of the Soviet people. His error, as it turned out, was attempting to preserve the Soviet bureaucratic structure while unleashing forces that destroyed the predictability and security of the old system.²⁵ Gorbachev probably wanted to change the economic factors, but the government and the economy were so intertwined that one could not be restructured without affecting the other.

Early Free-Market Mechanisms. Gorbachev implemented cost accounting as a way to introduce supply and demand, quality, and profitability into the Soviet economic lexicon. Within the enterprises that had viable markets, specifically the defense industry, profitability translated into greater wages and cost incentives. The consequence, however, was to increase subsidies to less profitable and efficient industries. Gorbachev's plan of price reform needed several years to operate, and in the meantime he bet on his ability to decentralize economic planning while simultaneously keeping the country committed to five-year production plans.²⁶ These were mutually exclusive goals.

Gorbachev certainly must have expected that the entrenched Soviet bureaucracy would resist his economic reforms. While Gorbachev expressed his frustration publicly,²⁷ the momentum behind reform accelerated as the republics, now more in control of their economic destiny, moved in similar directions. The grand problem, however, was that the growth in political unrest, both in Russia and the republics, forced Gorbachev to adopt a middle ground between his economic reforms and those of his principle political rival, Boris Yeltsin. In addition, the rising rate of inflation since the beginning of price liberalization fueled growing public discontent in Russia. This combination of forces accelerated the pace of reform, as Yeltsin, conservatives, and Gorbachev's moderates in the government engaged in a struggle that

ultimately brought down the Soviet Empire. In short, Gorbachev lost control of his own reform movement. The ensuing collapse worsened the country's economic malaise, because it destroyed precisely those institutions that provide central economic direction, but did not offer any viable alternative.

Accelerating Economic Decline and the "500 Day Plan."

It was clear by 1990 that the Soviet economy was collapsing. Official statistics documented a decline in the GNP of between one and two percent;²⁸ inflationary pressures forced the Soviet Government to print rubles at an even greater pace to finance the economy, but this only worsened the downward slide. In this climate, the Shatalin working group, composed of Gorbachev and Yeltsin advisors, presented a "500 day plan" to create a market economy in the Soviet Union. Predictably, the prescriptions for political and economic reform were so radical that the plan was rejected. What survived was a compromise plan — representing only a third of the steps envisioned in the Shatalin plan — that left out virtually all key features as well as the timetable for reform.

In the West, what became known as the "grand bargain" emerged as a new Marshall Plan, in which the West would provide roughly \$60 billion over three years to help Russia implement economic reforms.²⁹ Meanwhile, as the fissures in Soviet society continued to open, Gorbachev tried to patch together the government through presidential decrees.³⁰ The abortive coup in August 1991, marked the end of the reform process during Gorbachev's tenure.

Yeltsin's Economic Reforms. In parallel with the demise of the USSR on New Year's Eve in 1991 was the emergence of a loose confederation of states dominated by Russia, Russia's new president, Boris Yeltsin, and his group of reformers. In January 1992, Russia plunged headlong into the abyss known as "shock reform" in the hope of building a free-market economy. Yeltsin started almost immediately to privatize government property and enterprises, and this created shock waves whose reverberations still are felt in Russia. The supply of goods and services, long under the control of Moscow bureaucrats, was privatized, and as a result

the emerging network of businesses forced many old enterprises to dissolve. Those who had access to the new supply network emerged as the class of instant entrepreneurs in Russia's newly evolving markets. But the explosive growth in the profit margins of these newly created capitalist markets also fueled the growth of organized crime in the Russian market.

Inflation Exploded in 1992. The most important consequence of the partial implementation of the remnants of the 500 Day Plan under the guidance of Yegor Gaidar, Prime Minister and chief economic aide to Yeltsin, was the removal of price restraints. The Russian economy almost immediately experienced, amidst pent-up demand and high expectations, a bout of inflation that reached nearly 250 percent in January 1992.³¹ Wages rose less than prices, thus exacerbating the simmering wage crisis under Gorbachev.³² After 70 years of communism, price flexibility alone could not stimulate the supply response that price reform had produced elsewhere, such as those in Poland and the Czech Republic. We understand, however, that inflation represents both the availability of consumer goods in the economy and the effects of the Central Bank's policy of expanding Russia's money supply. While there were few consumer goods in the command economy and hence inflation was low, price liberalization coincides with an abundant supply of consumer goods. It is difficult to know whether the Russian people are worse off with inflation and a greater supply of consumer goods.

In the spring of 1992 Russia found itself entrapped in an economic crisis unprecedented since the Great Depression of the 1930s. In response to its looming economic problems, the Russian government imposed a radical reduction in subsidies to state industries from 12.5 percent of GDP at the end of 1992 to 7.4 percent by the end of 1993. This substantial decline in state subsidies had the predictable effect of swelling the ranks of the unemployed and fueling political discontent. But Yeltsin's early move to appease the conservatives by replacing the hard-line reformer Gaidar with the more moderate Victor Chernomyrdin as Prime Minister was viewed as a victory for the staunch communists and the Civic Union, a coalition of the industrial

lobby, conservative military, and supporters of a closer post-Soviet confederation.

Mixed Reviews on Reform. At this writing in early 1995, there are mixed reviews on the effects of economic reform in Russia. The often uncoordinated actions of the Russian Government since January 1992, reflect widely varied and competing views on what needs to be done to create a free-market economy in Russia. Those who are pessimistic argue that the reform rhetoric is dominated by preconceived notions about reform which do not correspond with the realities of change.³³ This view reinforces the feeling of pessimism about the chances for success, and argues that widely-divergent views about reform weaken Russia's ability to create a free-market economy. Other observers, however, argue that Russia's progress thus far is encouraging, and that the economy is showing signs of successful privatization and is in fact far stronger than many expected.³⁴

D. Impediments to Reform

Russia clearly faces a series of fundamental impediments to economic reform. In this section, we review the more dominant hindrances.

Free Market is Helped by Infrastructure. The dismal state of the physical infrastructure inherited from the Soviet era weakens Russia's ability to conduct free-market reform, and highlights the distance yet to be traveled by the Russian economy. It is important to understand, however, that it is possible to build a free-market economy without a modern infrastructure, as the case of China suggests. Nevertheless, economic development can proceed in Russia with the current infrastructure, although progress will be slowed.

The condition of the infrastructure is dismal at best. The road network throughout the great expanse of the Russian Eurasian landmass is sparse at best. What transportation system does exist is in terrible condition. Russia relies on largely primitive transportation networks for moving agricultural and industrial products throughout the country. It relies on decrepit and

inefficient systems for the movement of goods. Even the oil industry, which is one of Russia's more valuable commodities, is impeded by its inability to export its vast reserves. The deteriorating pipeline system is choked by bottlenecks and breakage, as exemplified by the massive oil spills in the summer of 1994. Russia lacks capital to invest in an industry whose fragmentation since the Soviet Union's breakup increases the difficulties of attracting the Western capital necessary for modernization.³⁵ Interestingly, the decline in Russian oil production slowed in 1994, as Russian output increased.³⁶

The sides of major roadways are crowded with trucks, carrying everything from construction material to gasoline, and dispensing their loads like flea markets in the United States. Despite the increase in automobiles over the past few years, there are few retail fuel sales facilities. Fuel sales are now supplemented by "privatized" fuel trucks selling gas alongside the roads at significantly higher prices. At an agricultural enterprise outside Moscow (which supplies McDonald's in Moscow), the distribution of agricultural products is made directly to over five thousand retailers because there is no wholesale distribution network. Senior government officials in St. Petersburg argue that it is essential to create an economic infrastructure that includes improved transportation networks.

Limited Successes of Privatization. Throughout 1993 and 1994, efforts to privatize the Russian economy clearly met with limited success. Despite the privatization of as much as 70 percent of Russia's industries and the conclusion of the nation-wide auction and voucher giveaways instituted by the Russian government in 1992 to enable its citizens to become shareholders in the economy, a genuine private economy is not imminent. The trappings of a free economy are visible but the reality is considerably different.

While it is estimated that more than 50 percent of Russia's gross domestic product is produced in the private sector,³⁷ a significant proportion of manufacturing still remains in the hands of the Russian government. On the other hand, the services industry, notably the restaurant and food service sectors, are being

converted to private ownership. The vast majority of collective farms — perhaps upwards of 90 percent — are now joint-stock companies.³⁸

Another problem faced by privatization is the inability to accurately estimate the cost of goods and services. Under the old Soviet accounting methods, which are still used by many companies, the absence of a firm understanding of costs leaves firms with little practical sense of whether profits are real or imagined. This condition creates numerous problems for newly privatized companies. First, there are powerful disincentives to outside investors to invest funds in a firm when they do not know the value of the firm. Second, managers are left with no sense of how to improve the profitability of the firm because, without a clear cost accounting system, profits and losses have no real meaning.³⁹

Stratification of Power. So deeply ingrained is the stratification of power in Russia's old bureaucratic culture, that it remains a fundamental determinant of policy, much as it did in the past.⁴⁰ The current debate within Russian policy making circles about the course of economic reform does not involve the rights or wrongs of developing free-markets in Russia, but the appropriate form and how to get there. Power in Russia is not diffused, and that fact impedes economic reform. For now, power remains centralized in ministries and enterprises.

Political Infighting. Russia's energies and attention are absorbed by struggles between various political factions. In late October 1994, a "no-confidence" vote proposed by the State Duma against Prime Minister Chernomyrdin and his reform-minded cabinet failed. As a key parliamentary supporter of reform argued, the defeat of the "no confidence" vote was not, "...a failure, but it isn't a victory."⁴¹ With many of its members elected from party lists rather than from direct popular election, roughly half of the Duma's members probably oppose plans to move rapidly toward a free-market economy. While there are enough proponents of economic reform to neutralize attempts to block reform, the struggle consumes the energies of Russia's political leadership.

The struggle between President Yeltsin and the Duma exemplifies this problem. In order to appease the opponents for

reform, in October 1994 Yeltsin dismissed the liberal Agricultural Minister Viktor N. Khlystun, replacing him with Aleksander Nazarchuk, a powerful member of the Agrarian party and closely allied to the Communist party — both opponents of Yeltsin's reforms.⁴² Each attempt to satisfy his opponents in the Duma forces Yeltsin to replace key economic policy advisors, even though each new advisor brings into office the baggage of these feuding groups which are competing for power in the government.

Industrial Subsidies. A tangible example of the power struggle is the continuation of the old Soviet policy of subsidizing inefficient sectors of the economy. In the summer of 1994, for example, the Russian Government loosened its tough fiscal policies when it issued another round of subsidies to support agriculture and industry. The predictable result was a significant rise in inflation in the autumn of 1994.

Inflation Roller Coaster. The chaotic nature of economic schizophrenia in Russia is symbolized by the hundreds of decrees that are enacted by President Yeltsin to deal with economic reform. But this chaos also was dramatized by the 21 percent drop in the value of the ruble on October 11, 1994 and the rapid rebound of the ruble's value several days later. This event spurred the resignation of the chairman of the Russian Central Bank, Viktor Gerashchenko. Though many factors contributed to this sudden drop in value, a prominent cause was the recent increase in central bank subsidies for failing defense enterprises and the agricultural industry.⁴³

Since January 1992, inflation remains an incessant problem for the stability of Russia's economy. Throughout 1993 inflation averaged nearly 10 percent a month, but stability seemed possible in 1994, when inflation stayed below 6 percent for much of the year. Two factors contributed to the sudden drop in the ruble's value and fears over its long-term stability. First, fiscal discipline was lacking. The Yeltsin government bowed to pressure and relaxed the tight monetary policies that seemed to be working when it provided help to the powerful agricultural, industrial, and defense lobbies. Second, the ordinary Russian was not willing to hold on to rubles because there are neither reliable mechanisms nor

compelling incentives to save and invest.⁴⁴ Furthermore, the Central Bank printed rubles at an annual growth rate of 15 percent during the summer months of 1994, presumably to allow the Russian Government to distribute subsidies. The situation leading up to the ruble's drop in value was exacerbated when the Central Bank bought rubles on the foreign exchange, thereby decreasing its dollar reserve, and weakening the government's ability to respond to currency fluctuations.⁴⁵ We must emphasize, however, that one reason for inflation is that the Central Bank is one of few instruments available for raising money in Russia — given that Russia's tax system is in disarray and privatization is proceeding slowly.

Inflation highlights some of the problems in the Russian economy. The incumbents still have a tendency from the old Soviet era to make government policy. In the case of the ruble's devaluation, the now-dismissed Central Bank chairman was not trusted by the reformers, because he was one who "...ran monetary policy out of his hip pocket, with no rules, no transparency, no commitment to the stability of the currency."⁴⁶ Significantly, the 1995 draft budget attempts to tighten Russia's monetary policies by terminating credits to Russia's inefficient industrial enterprises and farm sectors. The Duma approved a deficit of 73.2 trillion rubles — about \$18.3 billion — for 1995, which represents roughly 7.7 percent of the Russian gross domestic product.⁴⁷ Furthermore, even if this projected deficit for 1995 is missed, the Duma's action constitutes a significant step toward reining in inflationary pressures that were exacerbated by loans to these sectors during the summer and fall of 1995.⁴⁸

Reform of Taxation System. Russia's tax policies are so chaotic and the tax regime so unpredictable that a coherent climate of pro-reform incentives is difficult to realize. All told, Russian entrepreneurs face the burden of 52 taxes. Yeltsin's blitz of decrees since January 1992 only exacerbated the problem of high taxation. From higher taxes on employers who pay more than the decreed minimum wage to the value added tax that retards investment into capital improvements, these taxes complicate an already confusing environment for Russia's new capitalists.

However, Yeltsin won over converts to his reform programs early on with the promise to exact more from the rich to help finance the burdens of reform. But the initial 58 percent top marginal tax rate (reduced to 47 percent in the summer of 1994) created a pervasive practice of under-reporting income.⁴⁹ Moscow real-estate developers have long said that excessive taxes by the government, including the 23 percent value-added tax, impede construction projects because this reduces the profitability of such investments. In addition, local governments add other levies on investors and developers, such as the requirement to build gasoline retail outlets in addition to new office buildings. Moreover, there are many cases in which local governments preemptively transfer ownership of new enterprises to themselves.⁵⁰

A further complication in Russia's taxation system are the inconsistencies between the regional and local tax codes. There are as many as 67 different types of local taxes in Russia. Despite continuing efforts to restructure Russia's tax system, the emphasis on tax collection is at variance with the social conditions in Russia.⁵¹ Many Western observers argue that a just and modern tax system in Russia would collect vastly more revenue than international loans and assistance.⁵² Finally, Russia offers few services in exchange for the revenues collected from individuals or enterprises.

Property Rights and Nomenklatura Privatization. We cannot exaggerate the importance of the legal right to own property in building a free-market economy.⁵³ Property is an important source of power in Russia, although in the absence of legal protection, the *de facto* possession and enjoyment of the fruits of property — for example, control of exportable oil — remain more important than formal titles. In other words, "property" means access to assets at a time when most of the money and property in Russia are still an outgrowth of political position in the old order. This is what the Russians have in mind when they speak of "nomenklatura privatization."⁵⁴

Financial Markets and Investments. Russia's investment markets are beginning to realize their value in view of the level

of capital flowing into Russia's stock and bond markets, which already surpass government spending by 100 percent.⁵⁵ The rapid expansion of the bond market, though small by comparison with western nations, can serve as a source for helping the Russian Government service its debt. But the embryonic banking industry is still struggling to build the fundamental regulations on credit and investment that are necessary in an economy in which fraud is pervasive.

The increasing flow of foreign private investment into Russia in the middle of 1994 underscores the urgent need for stable monetary and capital investment systems.⁵⁶ In January 1995, foreign investment in Russia was down to \$20 million, the low-point in the last year.⁵⁷ Although foreign investment represents only a fraction of what is needed to rebuild Russia's industries, or even develop a comprehensive equity market, continued direct foreign investment has the beneficial effect of inculcating free-market concepts and practices. In turn, the development of a market economy depends on the ability of shareholders to hold management responsible for a company's performance. The management expertise of Western investors and managers is critical to the development of Russia's free-market economy.

The Problem of Unemployment. The pace of economic reform has direct consequences for social stability in Russia. If reforms are implemented too swiftly, it can produce greater unemployment and economic pain for the Russian people. In 1994 Russian unemployment was between 6 and 7 percent, representing between 4.7 and 5 million people. Another 4.6 million people worked short shifts or took unpaid leave. Moreover, Russian unemployment figures are unreliable because many fail to register their unemployment.⁵⁸

This problem is not lost on the Russian leadership. President Yeltsin acknowledged that the radical transformation of the Russian economy has painful consequences for the people, especially in the area of declining social support.⁵⁹ The divestiture of inefficient industries through rapid privatization led directly to unemployment for millions of Russians for whom joblessness

was unknown. To mitigate the effects of unemployment, many remain on the payroll of state industries — a fact that partially explains the trillions of rubles in subsidies that the government extends to many enterprises. Some enterprises use half shifts or keep workers on the payrolls even though they are not required to come to work, to lessen the effects of systemic unemployment. As a result, these actions misdirect scarce investment toward non-productive sectors of the Russian economy, and thus impede reform.

A Social Safety Net. Unemployment is worse than official government estimates lead us to believe. The official estimate on September 30, 1994 was that unemployment was only 2 percent. Other sources claim it may be as high as 10 percent.⁶⁰ With a jobless rate of perhaps five times the official estimate, the hidden costs of housing, and the “off the books” work being performed in essentially defunct industries creates a category of hidden unemployment. This further exacerbates the inefficiencies of newly privatized industries which feel obligated to house, feed, and educate its workers. Some argue that the creation of a social safety net not tied to individual enterprises would cost the Russian government less than sustaining inefficient industries.⁶¹ The subsidies to manufacturing firms are better spent on social programs to retrain and redirect the workforce, while industry devotes its capital to modernizing facilities and developing markets. In the short term, the reality is that conditions will only worsen for the average consumer. This search for a free-market economy will continue for decades before the path to economic revival is found.

Why Economic Reform is not an Option. The source of power in international politics now increasingly emphasizes economic growth and technological advance.⁶² For Russia to enter the global economy, it must strive to stabilize its economy through free trade. We need to remember, however, that it was the reality of economic decline that spurred Gorbachev to dismantle the command economy and usher in an era of reform. Some estimate that Russia, shortly before its dissolution as an empire, was investing as much as 50 percent of its national resources in the

defense industry, leaving little for capital investment, social infrastructure, or consumer goods.⁶³ This impediment, caused by dysfunctional investments, undoubtedly contributed to the disintegration of the Russian economy. Now Russia must transform its economy after nearly 100 years of mismanagement or face the prospect of political and economic irrelevance in the emerging international order.

E. Recommendations for Action

The challenge of building a market economy in Russia is complex and fraught with dangers. While there are several steps that Russia must take to move itself toward a market economy, the Russian leadership and people must understand that these recommendations must be pursued together, and that piecemeal efforts at reform are likely to impede progress.

Recommendation 1: Economic Reform Impeded by Political Turmoil. As long as Russia is gripped by political turmoil, it will find that the task of economic reform is doubly more difficult. The fact that the Russian cabinet has been replaced six times since the dissolution of the Soviet Union bodes ill for the future of economic reform. Despite disruptions along the way, Russia has made some progress in economic reform — for example, one-third of employment in Russia is claimed to occur in the private sector. While we can make recommendations *ad infinitum*, the reality is that President Yeltsin and the Duma must build political stability if they want to accelerate economic reform and establish the foundation for long-term economic stability.

Recommendation 2: Understand that Russia will Create its Own Economic Arrangement. While there are unifying features of all market economies — the free flow of capital and ideas — the United States must understand that Russia will create its own macroeconomic system. Some of its features will be identifiable, but in the broad sense the Russian economy will differ from those of liberal capitalistic states. During the next several

years, Russia will have to manage extraordinarily difficult economic problems — the unemployment that results from rapid privatization; the burden of millions of inefficient industrial workers; the grossly unequal distribution of wealth from unregulated privatization; declining government subsidies for the agricultural, industrial, and military sectors of the economy; the problem of inflation — as it creates an economy that is best for Russia. The West is advised to restrain the impulse to help Russia create mirror images of our own economic systems.

Recommendation 3: Construct “Social Safety Net” for Russian People. Economic reform is vastly more difficult when the social fabric of Russia is being destroyed in the process. Accordingly, the Russian political leadership must focus on constructing some form of a social safety net to protect the have-nots from the ravages of unemployment and inflation. While this observation is not new, we repeat to underscore the importance of social protection in maintaining political stability in Russia and thus alleviating the discontent that can explode into a revolution.

Recommendation 4: Control Price Stability. Russian efforts to establish budgetary discipline and thereby control inflation demonstrate that they understand how important price stability is to the survival of democratic reform. It is more difficult for Russia to sustain economic reform when foreign currencies, such as the US dollar, are the currency of preference because the markets and people lack confidence in the ruble. Because inflation has the insidious effects of penalizing those who live on fixed incomes, weakening the willingness of creditors to loan money, and reducing the real obligations of debtors, the Russian leadership must double their efforts to support tough measures that control inflation. In late 1994, Yeltsin's Deputy Prime Minister vowed to create a stable currency and lower inflation with the 1995 budget. The plan is to limit deficit spending in the national budget to only 7.8 percent of gross domestic product, down from 8.6 percent in 1994,⁶⁴ while exercising tighter control over the money supply. The

1995 budget reduces subsidies to the powerful agricultural and industrial sectors, but there remain worries that Yeltsin's government will yield to pressures to increase budget-busting subsidies.

Recommendation 5: Build Coherent Tax Policy. Modern societies depend on a regular flow of funds into the government to support national defense and the infrastructure. At present, Russia does not have anything that approaches a coherent system for the collection of tax revenues. What exists today is a panoply of taxes and measures that emerged during the last several years. The unfair and fraudulent system undermines the concept that all of the Russian people must share the burden of rebuilding their economy and society.

In addition to the usual measures, we believe that the most important step for the Russian government is to build a coherent tax reform policy that emphasizes measures to spur investment in the Russian economy — both by the Russians themselves as well as foreign investors. The measures taken thus far by the Yeltsin government, notably revenue enhancement by decree, must be replaced by tax laws that emphasize investment in business, while minimizing the tax burden on Russian consumers. A simplified tax code with the appropriate enforcement mechanisms at least will increase the incentive to pay one's fair share of taxes. It also will reduce the risk to foreign investors who are willing to put capital into Russia, but hesitate in the face of uncertain, and often changing, tax codes. A stable and predictable tax code in Russia will increase the flow of resources into Russia, thus enabling the Russian government to invest funds in rebuilding Russian society.

Recommendation 6: Invest in Russia's Infrastructure. Finally, Russia cannot hope to create a modern economy with its antiquated transportation and communications systems. The condition of Russia's infrastructure is so bad that it acts as an impediment to serious economic reform. The target of Russian and foreign investment must be to create a modern infrastructure in Russia so that it can compete in the global economy.

Notes

1. Edward A. Hewett, *Reforming the Soviet Economy: Equality versus Efficiency*, Washington DC: The Brookings Institution, 1988, p. 2.

2. See Vladimir Efimovich Gimpel'son, "New Russian Entrepreneurship," *Russian Social Science Review*, May/June 1994, p. 20, for the view of one Russian economist: "While it appears that communism has truly died, post-communist society does not originate in a blank space. We are dealing not with a 'tabula rasa,' but entirely concrete ruins that possess concrete national and regional features."

3. Daniel C. Diller, *Russia and the Independent States: Expanded Reference Edition*, Washington DC: Congressional Quarterly Inc., 1993, p. 14.

4. Roy D. Laird, *The Soviet Legacy*, Westport, CT: Praeger Publishers, 1993, p. 13, describes these three entities — the nobility, large landholders, and the Russian Orthodox church — which established a hierarchical structure that sustained itself by forcing payment and taxes from the peasants.

5. Diller, p. 14.

6. *Ibid.*, p. 19. To provide a living for the newly emancipated, the landholders were required, by decree, to distribute over half their land holdings to the serfs.

7. *Ibid.*, p. 22.

8. To keep the terminology clear, the "first" Russian Revolution is considered to have occurred in 1905, the "second" in March 1917, and the "third" in November 1917.

9. Paul R. Gregory and Robert C. Stuart, *Soviet Economic Structure and Performance*, New York: Harper & Row, 1986, p. 51.

10. *Ibid.*, p. 59.

11. See Gregory T. Grinko, *The Five Year Plan of the Soviet Union: A Political Interpretation*, New York: International Publishers, 1930, p. 9.

12. Diller, p. 43.

13. Hewett, p. 221.

14. Diller, p. 64.

15. Hewett, p. 225.

16. Diller, p. 70.

17. See Hewett, pp. 227–251, for a discussion of attempts to streamline the economic decision making administrative structure, merge differing industrial operations into production associations, and modify the strategic planning process, but the effect was marginal at best. Part of the reason for the less than

optimistic performance of the various reform programs stemmed from the resistance of state planners and central administrators who feared that the implementation of reforms equated to the loss of power that most bureaucrats seek to avoid.

18. Diller, pp. 80-97.

19. Despite the minimal effect on quality and technology, the Politburo extended the experiment to another 1,600 enterprises. See Hewett, pp. 257-265.

20. *Ibid.*, pp. 273-274.

21. See Marshall I. Goldman and Merle Goldman, "Soviet and Chinese Economic Reform," *Foreign Affairs*, America and the World 1987/1988, Vol. 66, No. 3, pp. 552-553.

22. See Mikhail Gorbachev, *Perestroika New Thinking for Our Country and the World*, New York: Harper & Row, 1987, p. 27.

23. See Georgi Arbatov, *The System*, New York: Times Books, 1992, p. 190, for the view that "If very high political and economic standards are applied to judging the development of society, the years between Khrushchev's removal and Brezhnev's death could be regarded as a period of stagnation."

24. See Gorbachev, pp. 28, 86, for his effort to implement, "substantial comprehensive programs...in major areas of science and technology." In Gorbachev's words, the motivations for his policies and the obstacles to be overcome demonstrated his insights into the process of forcing a major shift in investment and structural policy whose aim was to modernize the Soviet industrial base. He introduced the concept that every enterprise should proceed from real demand for their products to determine production goals; that their plans not be determined so much by higher bodies, "...but on direct orders placed by government organizations, self-accounting enterprises and trade firms for specific products of appropriate quantity and quality."

25. See Diller, p. 175.

26. Gorbachev, p. 88. His dilemma can be categorized as instituting reforms while simultaneously propping up the very institutional structures that have caused the decay. He stated in his plan that, "The composition and volume of state orders will gradually be reduced with the saturation of the market in favor of growing direct ties between manufacturers and consumers... When we have acquired the necessary experience, we will place state orders on a competitive basis, applying the principle of emulation, or socialist competition."

27. *Ibid.*, p. 91, for his view, when describing the changes he was trying to implement, that "The apparatus of the ministries, and ministers themselves, are unwilling to give up the habit of deciding minor matters themselves."

28. Edward A. Hewett, "The New Soviet Plan," *Foreign Affairs*, Winter 1990/91, Vol. 69, No. 5, p. 147.

29. See Graham Allison and Robert Blackwill, "America's Stake in the Soviet Future," *Foreign Affairs*, Vol. 70, No. 3, Summer 1991, pp. 77-98.

30. Hewett, "The New Soviet Plan," pp. 150-152.

31. See Shafiqul Islam, "Russia's Rough Road to Capitalism," *Foreign Affairs*, Spring 1993, Vol. 72, No. 2, p. 59.

32. See David Lipton, "Reform Endangered," *Foreign Policy*, No. 90, Spring 1993, p. 52, for his argument that the conflicting policies were, in effect, creating greater long term problems while attempting to address short term issues. Also see, Edward A. Hewett, "The New Soviet Plan," p. 147, for the discussion of "hot" money centers in terms of the propensity for consumers to spend their saved earnings quickly whenever goods appeared. In a society so accustomed to shortages over the years, any sudden surge of consumers goods was likely to have an effect of fueling inflation and exacerbate the shortage problem if the consumers were to dump their savings at once.

33. See D. Stark, *East European Politics and Societies*, Vol. 6, No. 1, 1992, p. 21, for his views in the *Russian Social Science Review* about "Actors who try to move in new directions find that their choice is limited to the existing stock of institutional resources. Institutions determine the field of action, block certain directions, and also favor the perception and selection of some strategies vis-a-vis others."

34. The varying extremes of analysis lie principally with the perspective one takes on the consequences of success or failure. For example, from a greater European continental security perspective, see Dietrich Genschel, "Russia and a changing Europe," *Joint Forces Quarterly*, Summer 1994, p. 25. A former senior NATO official, Dr. Dietrich Genschel stated that, "The reform process is not progressing successfully. The December 1993 elections did not produce a reform minded majority, though a simultaneous referendum gave birth to a democratically legitimized constitution. Most reformers in President Yeltsin's cabinet resigned or were not reappointed. Yeltsin has retained little if any authority to exercise the power that the new constitution vested in him. The best evidence of this fact was his inability to prevent giving amnesty to those involved in the abortive 1991 coup and in the revolt by parliament against him in October 1993. The various bureaucracies are the main shaping factors of policy, each following its own agenda with little or no coordination. The state Duma displays hectic activism in interfering with government policy without working on much needed laws to support further reforms. The economic, social, and legal situation is in a deplorable state. Russians have experienced only a caricature of what democracy and market economies truly mean in the west. Organized crime and corruption permeate the entire society. Many Russians, who saw their country as the center of the Soviet Union and Warsaw Treaty Organization, grieve over the loss of their role in Europe and the world as well as their self image. There is wide spread humiliation." For a review of the

macro-economic implications, see Anders Aslund, "Russia's Success Story," *Foreign Affairs*, September/October 1994, Vol. 73, No. 5, pp. 58-71.

35. See Bhushan Bahree, "Russian Oil Spill Spotlight Need To Upgrade Poor Pipeline System," *Wall Street Journal*, October 28, 1994, for the views of analysts of the oil industry who argue that "The infrastructure is badly out of shape and they don't have the money to fix it."

36. See "Russian Oil-Output Decline Slows," *Wall Street Journal*, January 19, 1995, p. A14.

37. "Under New Management," *The Economist*, October 8, 1994, p. 22.

38. See Sonni Efron, "Growing It — And Going Nowhere," *Los Angeles Times*, June 21, 1994, pp. 1, 4.

39. For an excellent discussion of the effects of capital investment and the newly privatized companies, see "After the Fall," *The Economist*, September 24, 1992, p. 77. Also, see Robert McGough and Neela Banerjee, "Bullish Mutual Funds Chase Russian Bear," *Wall Street Journal*, November 3, 1994, p. C1. The concern for the many foreign investors lining up at the Russian border is summed up by Mark Madden, manager of the mutual fund Pioneer Emerging Markets, who said "The problem is, there's no way to value any of these companies."

40. See Roderic Braithwaite, "Russian Realities and Western Policy," *Survival*, Vol. 36, No. 3, Autumn 1994, p. 14, for reflections on the times in Tsarist Russia, when the Tsar had to share his autocratic power with the "great Baronies" of the army, the police, and the bureaucracy. Even during the height of Soviet communism, the party shared its power with the *nomenklatura* of the party and government, the bosses of industry and agriculture, the armed forces, the KGB and its predecessors.

41. Adi Ignatius, "Chernomyrdin Survives Vote of Confidence," *Wall Street Journal*, October 28, 1994.

42. Steven Erlanger, "Defending Austerity, Russia Government Survives a Vote," *New York Times*, October 28, 1994, p. A3.

43. See Claudia Rosett, "Eccentricity Plays Star Role in Stage of Russia Economy," *Wall Street Journal*, October 17, 1994, p. A10, for a discussion of the fact that, in the murky Russian laws, the Central Bank chairman cannot be fired without the approval of the lower house of parliament, or State Duma. But in this case, to calm fears of instability before an upcoming no confidence vote for the cabinet of Prime Minister Chernomyrdin in the Duma, Yeltsin pressured Gerashchenko into resigning without the Duma's vote in a deal agreed to by the Duma speaker, Ivan Rybkin. The political motivation behind these drastic personnel actions are discussed in Philip Hanson, "The Future of Russian Economic Reform," *Survival*, Vol. 36, No. 3, Autumn 1994, p. 28, when he points out that "The attempt at building capitalism in Russia is, after all, political."

44. Steven Erlanger, "The Russian Illness," *New York Times*, October 14, 1994, p. A4.

45. Editorial, *Wall Street Journal*, October 12, 1994, p. A16.

46. Jeffrey Sachs, a Harvard economist who was an advisor to the Russian government, as quoted in Claudia Rosett, "Eccentricity Plays Star Role in Stage of Russia Economy," p. A10.

47. See Neela Banerjee, "Russia's Duma Agrees to Cut Deficit for 1995," *Wall Street Journal*, January 26, 1995, p. A10.

48. See Adi Ignatius, "Chernomyrdin Survives Vote of Confidence," *Wall Street Journal*, October 28, 1994; Steven Erlanger, "Defending Austerity, Russia Government Survives a Vote," *New York Times*, October 28, 1994, p. A3; Steven Erlanger, "I.M.F. Talks With Russia Fail to Reach Loan Agreement," *New York Times*, February 8, 1995, p. A7.

49. Editorial, "Russia's Terrible Taxes," *Wall Street Journal*, November 18, 1994, p. A18.

50. Mikhail Dubik, "Tender Requirements Scare off Developers," *Moscow Estates News*, September/October 1994, p. 6.

51. Irina Yasina, "Finance Ministry Intends to Reform Tax System," *Moscow News*, No. 37, September 16-22, 1994, p. 8.

52. See Steven Erlanger, "I.M.F. Talks With Russia Fail to Reach Loan Agreement," *New York Times*, February 8, 1995, p. A7.

53. "The delineation of property rights is necessary if any society is to operate effectively; property rights function by conveying 'the right to benefit or harm oneself or others. Harming a competitor by producing superior products may be permitted, while shooting him may not. A man may be permitted to benefit himself by shooting an intruder but be prohibited from selling below a price floor.'" See Harold Demsetz, "Toward a Theory of Property Rights," *American Economic Review, Papers and Proceedings* 57, 1967, pp. 347-359. Passage quoted in Robert Gilpin, *War and Change in World Politics* (New York: Cambridge University Press, 1983), p. 17.

54. Daniel Yergin and Thane Gustafson, *Russia 2010*, New York: Random House, 1993.

55. "Under New Management," *The Economist*, October 8, 1994, p. 22.

56. See Richard W. Stevenson, "Foreign Capitalists Brush Risks Aside To Invest In Russia," *New York Times*, October 11, 1994, p. C1; also Robert McGough and Neela Banerjee, "Bullish Mutual Funds Chase Russian Bear," *Wall Street Journal*, November 3, 1994, p. C1.

57. See Neela Banerjee, "Russia's Duma Agrees to Cut Deficit for 1995," *Wall Street Journal*, January 26, 1995, p. A10.

58. See "Russian Payrolls Shrink," *Wall Street Journal*, October 31, 1994, p. A10.

59. See Anatoly Verbin, "Yeltsin says Russians Tired in Market 'Typhoon'," *Reuters News Agency*, November 18, 1994, for Yeltsin's view that, "We had to start reform so quickly that regretfully we did not have time to prepare all the safety nets."

60. Richard L. Holman, "Russian Joblessness Understated," *Wall Street Journal*, October 28, 1994, p. A16.

61. There are two issues involved with this statement. First, the impact of an implicit welfare system would serve to, "prevent undesirable changes in the distribution of income, and particularly in protecting the worse-off members of society from the adverse effects [of reformation] on their living standards." See Jim Leitzel, "Western Aid and Economic Reform in the Former Soviet Union," *World Economic Review*. Second, the existing system of state-run stores and offices for the distribution of rations and goods would not require a substantial investment. It is a system that has existed for many years. This system then would relieve the burden currently shouldered by industry, allowing it to invest its capital, such as there is, into those capital intensive operations that make it a profitable concern. That would have the added effect of creating tax revenues for the state, which could then use those revenues for infrastructure, welfare, and so forth. The perception that industry cannot just dump its people into the society is a holdover from the communist era of just a few years ago. In discussions with a senior business executive in a large privatized firm in St. Petersburg, the view is that it is the company's duty to provide housing, day-care, and help provide for the subsistence of its employees; and to find work for them in other areas of the company if they could not be used in their present jobs. There is a clear hesitation to layoff people.

62. See Gilpin, p. 123.

63. Author interview in St. Petersburg, September 1994.

64. See Steve Liesman, "Russia's Economic News: Its Not All Bad," *Wall Street Journal*, November 28, 1994, p. A14.

Chapter 6

Russia's Banking and Financial Crisis: Managing Reform

by Bruce E. Burda

- A. The Problem
 - B. The Current Situation
 - C. Problems In Russia's Financial Sector
 - D. Recommendations for Action
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A. The Problem

The republics of the former Soviet Union face numerous challenges as they develop into independent and democratic states with free-market economies. Russia, in particular, must overcome its dismal history as the exemplar of a massive, centralized bureaucratic state that controlled all economic activity.

With this in mind, a significant hurdle in establishing a viable free-market economy in Russia is the lack of an independent, functioning financial sector. In essence, Russia is not so much evolving economically as it is starting from scratch. Consequently, a key to Russia's long-term economic success rests with the development of a stable, independent financial sector that encourages investment, stimulates capital formation, and eliminates excessive governmental regulation. Specifically, reform in the banking industry and the associated economic policies that govern this rapidly growing area will help settle the current chaos that engulfs Russia in 1995, and it will establish the foundation for the development of a free market economy in Russia.

As in many other areas, Russia's leadership has not taken many positive steps to build a coherent banking structure. What banking industry that exists emerged relatively quickly, and did

so without many of the procedures and supporting regulations that are essential in a free market economy. And now, the Russian government must catch up with the private sector to ensure that there are adequate procedures in place to protect the banks that are a source of economic growth. The industry needs immediate and carefully-developed guidance if it is to build a financial foundation that will support future economic development.

There is no doubt that the financial sector and the banking system in Russia are decisive factors in promoting the economic growth, privatization of government-owned businesses, and low inflation and interest rates that are vital to Russia's continued progress toward a prosperous free-market society. This chapter examines the financial and banking sectors in Russia by addressing the broad fiscal policies influenced by the Central Bank of Russia (CBR) and several critical commercial banking issues. This analysis of financial conditions in the overall economic climate in Russia today addresses many of the potential problems that challenge reform in the financial and banking areas. Finally, it provides recommendations to assist Russia in ensuring future economic growth and stability.

B. The Current Situation

Background. To begin with, the old Soviet banking and financial systems destroyed Russia's experience with developing a sound and secure banking system for a market economy. Despite this void, Russia showed some progress in the financial area since the collapse of the Soviet Union.

Centralized Economic and Bank Activity in the Soviet Era. Before the demise of the Soviet Union, the communist government maintained strict control of the economy. Along with industrial and agricultural activities, the Soviet government dictated economic policy through centralized plans which contained broad policy guidance as well as detailed tasks and goals for the various sectors and branches of the economy. In addition, the government prepared short-term plans, controlled investment, determined wages and incomes, and fixed prices of most commodities and products — all elements of a command

economy. As a result, the country lacked any real private economic sector, even after reform efforts made since the mid-1960s.

Prior to 1987, banking activity was owned and controlled by the Soviet government through the State Bank, or Gosbank. It functioned somewhat like a Western central bank, but it exercised significantly more influence in the areas of routine governmental activity. In fact, Gosbank was one of the primary instruments of communist control over state enterprises. The state bank was responsible for controlling currency circulation and for executing the government's financial and credit policies. In addition, Gosbank was responsible for overseeing foreign trade and other external activities.

As the central bank, Gosbank provided the monetary strategy to support the government's five-year plans. More specifically, it monitored the performance of state enterprises, held their accounts, handled their receipts and payments, and provided short-term credit. Money and credit were of little importance in directly influencing economic activity, but were essential in helping the Soviet leadership achieve the goals outlined in the centrally-determined economic plans. In order to encourage deposits, the state banks paid interest on individual savings accounts, and in turn the deposits from these savings accounts were used to fund state investments and control inflationary pressures. Subordinate to Gosbank were two specialty banks that handled specific transactions: the Bank of Foreign Trade which financed foreign trade, serviced external debt, and handled foreign exchange transactions; and the Construction Bank which provided long-term credit to state enterprises and organizations.

Under a reorganization effort in 1987, the Soviet government expanded the banking system to include five specialized banks. These consisted of the two original ones that underwent some modifications and three new ones: the Agro-Industrial Bank, the Bank for Housing, Municipal Services and Social Development, and the State Savings Bank (Sberbank). Gosbank still maintained control over these five banks, but the banks retained control over policy and operations within their specialized areas. The new two-tier system was designed to free Gosbank to manage the total

money supply and credit, while giving responsibility to the specialized banks for commercial banking operations. In particular, Sberbank was the state's largest bank, maintaining over 79,000 branches throughout the country. It rendered basic banking services to the general public and collective organizations. However, the banking system in Russia was not an integral part of normal economic life.

Significantly, the old system did not require information regarding the credit-worthiness of potential borrowers; nor did it have a specific legal structure for collecting debt.¹ Such background information was unnecessary, because the fact that money was lent from one state enterprise to another meant that repayment was virtually guaranteed. In addition, the fact that the question of liability for non-payment was essentially moot negated the need for legislative codes and regulations.

Russian Regulatory Agencies. The Russian securities market presently consists of three primary regulatory agencies: the Finance Ministry, the State Committee for the Management of State Property (known by its Russian abbreviation GKI), and the Central Bank of Russia.² The Finance Ministry provides the majority of securities market regulation, playing a role much like the United States Securities and Exchange Commission. It establishes the regulations for all securities market participants and instruments. The specific functions of the Finance Ministry include registering and setting the requirements for issuers and issues of securities; approving prospectuses for securities issued by joint-venture and Russian-owned companies; granting licenses and supervising brokerage firms, stock exchanges, and other commodity and currency exchanges that trade securities; and licensing and regulating investment companies and investment funds.³ The chief responsibilities of the GKI are to oversee the initial issue and registration of equity shares by newly-privatized enterprises, and to license and regulate the privatization voucher system for investment funds.⁴

The CBR was founded in 1990 by two decrees — the Central Bank Law and the Commercial Banking Law. These laws proclaimed the banking sector to be an essential arm of Russian

economic policy, and articulated the goal of establishing a more Western-style banking industry independent of state control.⁵ The Bank is charged with regulating commercial banks (when they participate in the securities market) and registering the primary issue of bank shares. In addition, the CBR is the fiscal agent of the Finance Ministry in the case of the primary issuance of government securities and supervising the secondary market trading in such securities.⁶

Political Control Over Central Bank. Initially, the CBR fell under the control of the Supreme Soviet, and thus was given more responsibilities than those assumed by Gosbank. When the new Russian Constitution was adopted in 1993, the intent was to establish the independence of the CBR from the political influence of both the president and the parliament.⁷ However, the chairman of the CBR is appointed by the president for five-year terms, approved by the State Duma, and always remains subject to presidential decrees. Thus, the fact that presidential influence is still overt weakens the independence of the CBR.

Emergence of Private Commercial Banks. In 1988, the Law on Cooperatives authorized the creation of cooperative banks to support the needs of cooperative institutions. By the fall, private commercial banks began to emerge, and with the acceleration in the trend to commercialization, more than 2,200 commercial banks rapidly emerged during the next three years.⁸ Moreover, in 1990 the specialized state banks started to convert to joint-stock companies.⁹

Today, the Russian banking industry is characterized by a small number of large state banks and numerous small commercial banks, all of which must be licensed by the Central Bank. There are currently about 2,000 banks in Russia, but only about 50 banks offer customer services approaching Western standards. Of the total, nearly 40 percent are concentrated in Moscow, a disproportionate number given that only 10 percent of the Russian population resides there.¹⁰ Regarding ownership, a shareholder may not own more than 35 percent of the outstanding shares despite the fact there are no clear tests for ownership.¹¹

We can offer several insights into the types of banks that are emerging.¹² These banks either evolved from the former Soviet Gosbank, were founded through association with a government ministry, or emerged as independents.¹³ Not surprisingly, the fact that banks with ministry “sponsorship” experienced the fastest rates of growth suggests that relationships with governmental agencies are beneficial to their development.

Old Communist Elites Penetrate Banking System. It is obvious that the new breed of Russian banks maintains strong ties with former ministries and state enterprises. There is evidence that the new owners are the old communist elites who discovered a different way to exercise power.¹⁴ The old government bureaucrats discovered that one way to maintain control and ensure their economic and social survival is to establish banks that are associated with their old industries. This is possible because the banks offer a convenient means to hold the capital of former state enterprises and thus provide them with “cheap money” when it is advantageous.¹⁵ In many instances, the banks conduct business almost exclusively for their sponsoring enterprises.

Conduct of Business. After the Soviet collapse in 1991, the eagerness of most debtors to default left many banks and state enterprises holding vast sums of worthless receivables.¹⁶ Despite this setback, the banking industry continues to grow, often at unprecedented rates. The generation of new banks tends to be relatively small — 90 percent have a capital base less than \$1 million, with a considerable difference in age and experience among the banks’ management personnel.¹⁷ While the CBR reviews the bank officers’ experience, there are no established criteria for evaluating individual skills or knowledge. Many of the banks, wishing to establish ties with defunct state banks or ministries, hire former senior leaders to fill key positions in the banks. Generally, each bank is managed by a board of directors that is comprised of all shareholders in the bank. In reality, they provide general oversight, while the Bank Council (made up of the largest shareholders) is responsible for the detailed functions of management. Understanding their lending practices lies at the heart of deciphering how business is conducted in Russia.

The commercial banks have a strong tendency to make loans to firms associated with, or at least known to, the owners of the bank. This familiarity through personal knowledge gives the owners reasonable assurances that the loans will be honored.¹⁸ It also reduces the bank's transaction costs for screening applicants, monitoring borrower performance, and collecting late payments.¹⁹ Conversely, the working relationship minimizes the cost to the borrower because it eliminates the need to conduct research on the performance of different banks before choosing one. With the current difficulty in obtaining information on business performance in Russia, the present system is a reasonable alternative.

The interest rates charged to lenders in Russia are very low in relation to predominantly high inflation rates.²⁰ In late 1992, the CBR was lending money to commercial banks at a rate of roughly 5 percent a month while inflation was nearly 25 percent per month.²¹ Commercial banks, in turn, charge artificially low rates, so that these negative lending rates (in real terms) create what amounts to be Central Bank subsidies in the form of credits. The interest rate for one-year government bonds in the Russian security market was 162 percent in 1994.²² Another reason for the low rates is the threat of action from the central bank if commercial rates are deemed "excessive."²³ A possible outcome from the high inflation, low interest rates, and a primitive regulatory arena is an increase in speculative activity by companies and individuals who are lured by hopes of making easy profits.

C. Problems In Russia's Financial Sector

As mentioned earlier in this chapter, Russia must overcome three main problems with its financial system. The first is the lack of a historical framework for an independent banking and financial sector. However, it is important to recognize this void because it shapes future attempts at reform. To reverse the absence of a viable financial sector, Russia is beginning to build a foundation for continued growth and development that involves more than making minor adjustments to its economic and political structures and regulations.

The remaining two problems stem naturally from the first. The second is that an independent, private financial sector must be developed in Russia for it to successfully evolve into a free market economy. And third, the Russian leadership failed to build a credible banking structure to support a new financial sector. The following discussion outlines specific problems associated with the development of a free market economy and a solid banking sector.

Bouts of High Inflation. High rates of inflation remain a significant problem for Russia. Through the first half of 1994, the pattern of high inflation continued at a rate of 20 percent per month, but reached a low of 5 percent in August.²⁴ This appeared to be good news for the economy, but rates fell because the Central Bank drove interest rates to historically high levels. When this action eventually paralyzed economic activity, the CBR flooded the market with new rubles in an attempt to bring interest rates under control.²⁵ As a result, inflation once again soared. Moreover, the CBR reversed its tight monetary policy and released new credits to cover the government's budget deficit and to help decrease the growing debts of favored enterprises. Unfortunately, the additional credits quickly ended up in the foreign exchange market, causing an inflationary spiral that reduced the value of the ruble.²⁶ This, in turn, added to the upward inflationary spiral and a corresponding devaluation of the ruble.

During a three-week period in late September and early October, the value of 1,000 rubles fell from 46 cents to 34 cents. On October 11, or Black Tuesday, the value of the ruble fell to 25 cents and eventually regained ground to 33 cents by the end of the week.²⁷ This collapse was produced by traders who unloaded more rubles into the market when they realized the Central Bank had expended most of its dollar reserves in an attempt to support the ruble. One observer argued that the unstable currency was the result of a Russian monetary policy that, "has been in the hands of a few powerful people who understand little and care little about normal monetary policy and instead view Central Bank credits as a resource to be manipulated at will for short-run advantage."²⁸ More importantly, a developing free market economy cannot survive if people refuse to keep currency because its value dwindles

daily. Without an incentive to save, deposits will decline and, in turn, the amount of capital the banks can provide for investment will fall.

Central Bank of Russia is Not Independent. As mentioned earlier, the Central Bank of Russia is supposed to be independent of the president and parliament. Yet, both President Yeltsin and the parliament successfully influence its decisions and actions. This is due partially to a wholly inadequate legal infrastructure that does not provide proper legislation, supervisory institutions, or an effective court system to support a cooperative, but independent relationship.²⁹ Furthermore, the new constitution gives the president such immense power that the chairman of the CBR is not able to remain autonomous during long-running disagreements over policy. This is exactly what happened in October when the CBR Chairman, Viktor Gerashchenko, was essentially fired after Black Tuesday. The political reality in Moscow means that the CBR cannot operate in a vacuum, but must be somewhat responsive to both the president and parliament, especially in an era that requires such fundamental and dramatic reform.³⁰

Central Bank Subsidies to Failing Industries. The Central Bank's policy regarding subsidies to state enterprises causes other problems. One of the reasons for the chronic high inflation rate stems from the fact that the CBR provides, "excessive funding to inefficient industrial enterprises," in order to maintain production levels and employment for millions of Russians.³¹ This support for industrial output conflicted with the stated constitutional purpose of the CBR, which is to protect and maintain the stability of the ruble.³² Subsidies and credits allocated to poorly performing companies detract from the CBR's efforts to control inflation. This was the situation in the third quarter of 1992, when the CBR increased its lending to commercial banks from 580 billion rubles to 1.5 trillion, in a pattern repeated most recently in the fall of 1994.³³ The CBR's attempts to deal with so many issues simultaneously make it more difficult to solve any one problem, and as a result the economy gyrates wildly at a time when it needs to achieve stability.

Absence of Credible Legal System. Throughout the economic sector, the lack of standardized and predictable legal procedures acts as a barrier to investment and hinders the orderly development of many financial activities. Inadequate legislation makes it difficult to enforce claims or resolve disputes. This is a particularly gnawing problem within the securities market because no securities laws exist to protect institutions or individuals. Nor can Russia ensure the integrity of the markets unless there is adequate legislation to cover conflicts of interest, insider trading, price manipulation, fraud, and false advertising.³⁴

The numerous decrees, regulations, and procedures issued by various regulatory agencies have fallen short of the need for a comprehensive set of laws.³⁵ It is fortunate that a wide range of legislation is currently being drafted. The Russian Federal Commission on Securities and Stock Exchanges (RFCSSE), established by presidential decree in March 1993, is working on legislation to establish standards for the issuance and trading of securities, shareholders' rights and meetings, and advertising (to include measures to counter fraud).³⁶

Absence of Stock Market Regulations. In addition, Russia does not have a system for regulating the actions of brokers and exchanges. The government encouraged their development, however, and the RFCSSE is preparing legislation for self-regulatory organizations.³⁷ Given Russia's immense size and various exchanges and participants, many policy officials believe that self-regulation will take on a much greater role in market activities — at least in comparison with the centralized control of the Securities and Exchange Commission in the United States.³⁸ But it also will leave unchecked the abuses that often occur in financial markets.

Inchoate Taxation System. Another problem facing the financial sector is the lack of an effective taxation system. Currently, taxes on profits from foreign investments and joint-ventures are incredibly high, which weakens the incentive for foreign businesses to enter the Russian market. There are other taxation issues that negatively affect the liquidity of the market, including the 6 percent tax on trades, taxes on capital gains paid

by the seller, and taxes based on revenues rather than profits.³⁹ Another issue adding to Russia's economic woes is the ability of companies, banks, and even some governmental agencies to retain money in foreign currencies, most notably dollars, without the knowledge or control of the government.⁴⁰ Money stashed outside the country circumvents the tax system, thus making it even more difficult to balance the budget, make debt payments, provide services, and bolster the banking system. In general, the tax system is not well structured to generate a predictable atmosphere for generating business revenue for government spending and budget planning.

Credible Banking Sector Essential. The lack of an effective legal system in Russia also hinders the development of a stable banking industry. As Boris Fyodorov, Deputy to the State Duma, argues, no one in Russia knows anything definite about the numerous regulations, decrees, policy instruments, and the Central Bank's relationship to the government.⁴¹ For example, without clear legislation, it is difficult to properly settle defaulted loans and collect debt. Some existing laws need to be changed, such as the current tax codes which discourage banks from declaring bad debts because the lost principle is not deductible for tax purposes.⁴²

Government Involvement in Banking Operations. Another problem within the banking sector is the level of CBR involvement in the commercial area. There seems to be a conflict of interest when the CBR participates in the capitalization of state banks, such as the Bank of Foreign Trade, the Savings Bank, and the Soviet Trade Financing Bank. The CBR is charged with regulating the industry, while at the same time making business decisions about the viability of its own banks. Furthermore, state banking officials have a vested interest in the continued distribution of credits under the guise of assisting commercial banking operations. This impossible task of balancing opposing interests not only creates critical decision-making challenges, but raises doubts about and weakens public support for governmental policies.⁴³

Limited Western-style Banking Practices. Although several of the largest Russian commercial banks come close to western standards, most banks are still struggling to provide many

of the services found around the world. Russia is gripped in a transitional period in ways in which many of the following services are performed — deposit taking, transfers/payment orders and other cash services, commercial lending, project financing, and foreign exchange operations. The payments, clearance, and settlements system are still not satisfactory. Official and private clearing procedures are improving and expanding, but the sheer size of the country hinders rapid development. The CBR is installing electronic data processing and communications facilities for an official clearance system, but many transactions are still managed on paper. The result is unnecessary delays that impede the creation of nationwide markets for government and private securities. CBR officials hope their upgrades will be completed within a few years.⁴⁴

Within the private banking sector, services are even more primitive. Private banks offer deposit accounts for individuals and all extend credit, and interbank transfers and electronic clearances are evolving in the larger cities, but this hardly constitutes a national system in Russia. Despite the fact that individuals rarely have credit cards or use checking accounts, Stolichny Bank was the first to introduce credit cards in 1993 and Sberbank was trying to introduce a debit card for wide-spread use in early 1994.⁴⁵ A few banks are now issuing their own debit cards and some banks are starting to issue international credit cards such as VISA, Mastercard, and American Express. The debit cards are convenient, safe, and have the added advantage of automatically converting into rubles at the wholesale market rate.

Automated teller machines (ATM) are emerging, but only in the Moscow area. International financial transactions are also available in some areas within the SWIFT system, allowing standardized and electronic transactions between some Russian and foreign banks.⁴⁶ However, retail banking is generally just beginning to meet western standards, and then only in major cities. Most of the country remains a cash-based society with few automated or electronic services.

Low Savings Rates. There are many problems associated with the uncommonly low interest rates in Russia, but the biggest

drawback affects depositors. As mentioned earlier, the government charged interest rates substantially lower than recent inflation rates. Likewise, private Russian banks pay savers correspondingly low interest rates on their savings accounts. The result is an investment that is good at face value only, and which actually loses value in real terms. Marginal income that might be saved is hard enough to come by in Russia, as high rates of inflation decrease the already small incentive to save. Not surprisingly, savings rates have fallen in Russia. During one period from May to September 1992, they fell from 20 to 13.5 percent.⁴⁷ Continued decreases in deposits will only reduce the amount of capital available for loans and other private and commercial investments, and thus slow the pace of economic growth. In addition, banks cannot survive in a climate of negative growth. They must receive credits from the government to remain solvent or face bankruptcy, but neither outcome is desirable or sustainable if Russia seeks to create a healthier economy.

Lack of Deposit Insurance. Russia currently does not have a uniform insurance system to protect bank deposits. The federal government automatically insures household deposits with the Sberbank, but Russia does not have a designated fund for the banking industry. From July 1991 until December 1993, commercial banks contributed to two funds controlled by the CBR, a Bank Insurance Fund and a Bankruptcy Fund.⁴⁸ If a bank declares bankruptcy and closes, a liquidation commission receives the funds' assets for the purpose of settling claims. Although banks are closed by the CBR, none have declared the condition of bankruptcy that frees the funds for disbursement. As of January 1994, the Bank Insurance Fund was eliminated and its funds returned to the banks. The Bankruptcy Fund is still intact, but commercial banks no longer actively contribute to it.⁴⁹ This still leaves the industry without a fair and practical system to protect depositors' money. As a result, the Russian Central Bank is creating a deposit insurance system to protect investors.⁵⁰

Credit System Limits Cash Flow. Another problem facing commercial banks is that the cash and credit system remains a relic of the Soviet era. The exchange of cash into bank credit and

vice versa is not permitted on a uniform basis in Russia.⁵¹ Enterprises buying and selling through a bank are credited with the transactions, just as they were in the central planning days. Cash is not received and it is not necessarily paid out, but if a company wants cash, it must obtain it through a separate pool of money. And as checking transactions are still quite uncommon at most banks, the fact that Russia tends to rely on cash transactions causes a shortage of cash needed by growing enterprises and creates an extremely slow, unfriendly accounting process.

D. Recommendations for Action

As the Russian economy makes slow progress toward a free market, it is not surprising that some areas of the economy are developing more briskly than others. The recommendations in this section focus on the major problems with the banking sector which Russia must resolve.

OBJECTIVE 1: Develop an Independent, Stable Financial Sector. The first objective for Russia is to develop an independent and stable financial sector that provides a foundation for future economic growth. Although President Yeltsin and the government have started many programs, there is much to be done to encourage capital formation in Russia and promote investment opportunities for domestic and foreign entities. A positive sign was President Yeltsin's decree in November 1994 to form a commission, headed by former privatization minister Anatoly Chubais, to regulate and enforce the security and capital markets in Russia. This Yeltsin decree rules that a license is needed to trade securities, stocks, or bonds.⁵² This is a significant step toward the creation of a stable banking and financial system in Russia.

Recommendation 1: Create Independent Russian Central Bank. To be frank, the Central Bank of Russia is not an independent agency. The Central Bank is the instrument by which Russia creates a sound monetary policy, and to do its job properly it must insulated from the activities and pressures of the

government. The government must take steps to enforce the independence of the Bank by insulating it from undue governmental influence as it establishes monetary policy. The CBR must clearly understand that its primary responsibility is to protect the value of the ruble.⁵³ Russia needs to enact legislation that creates acceptable target rates of inflation which the Central Bank must manage. Furthermore, the chairman of the Central Bank must pursue policies that protect price stability and fight inflation, and must be held accountable for the success or failure of CBR policies.

By clearly stating that the CBR's main purpose is to ensure price stability, it will limit the incentive to use the CBR as a source of the subsidies for industrial enterprises which thus far have fueled inflation. While the independence of the CBR is the key to controlling inflation, independence also matters because it enhances the credibility of the government in economic policy. The argument — that independence deprives the Russian president of total control over the economy — is not convincing when we consider the policies of the major industrialized states.⁵⁴ Finally, Russian economic reform will benefit if the Finance Ministry, Central Bank, and Duma can develop a more cooperative attitude, while still preserving the political independence of the Central Bank.⁵⁵

Russia also might consider forming a currency board which seeks to keep the ruble tied to the value of a stable foreign currency, such as the dollar. For example, the IMF seeks to establish a \$6 billion fund to stabilize the ruble by tying its value to the dollar.⁵⁶ This step would eliminate speculation in currency exchange rates, reduce the flight of capital out of Russia, and lessen inflation.⁵⁷ The objective is to minimize the chaos in economic policy that results from the interplay among competing interests, and thereby create more coordination among the governmental agencies that are responsible for strengthening Russian economic reform.

Recommendation 2: Eliminate Wasteful Subsidies to Inefficient Businesses. For the sake of emphasis, we recommend that the CBR substantially reduce subsidies to failing state

enterprises. This will have the immediate effect of stabilizing the ruble's value and thereby reduce inflationary pressures in the Russian economy.⁵⁸ This involves painful choices for Russia as the decision to eliminate subsidies ultimately means that inefficient businesses will be privatized or allowed to collapse, with corresponding effects on employment and social stability.

Recommendation 3: Reform Russia's Security and Banking Laws. To promote economic reform, it is essential for Russia to accelerate reform in its security and banking laws. Russia needs laws to resolve deficiencies in the securities market as a way to establish clear standards and accounting principles in the banking sector. Specifically, the government needs to establish clearly-defined bankruptcy procedures and rules to protect collateral and banking reserves. A corollary is that Russia must reform its tax codes to create an equitable taxation system in order to assure that domestic and foreign investors are not subject to capricious or prejudicial treatment.

OBJECTIVE 2: Build a Credible Banking System. Russia must build a modern, efficient, and credible banking system to support free-market reform and build a framework for routine business transactions. A solid banking system encourages individuals and businesses to invest in Russia without fear of illegal interference or unexpected losses. While Russian commercial banks have instituted more reforms than the private banks, problems continue to plague both sectors.

Recommendation 1: Disengage CBR From Banking Operations. The CBR must divorce itself from the commercial banking business to eliminate the conflict of interest that undermines confidence in its policies. As long as the CBR retains ties to individual banks, the public will question its impartiality and ability to regulate the economy. By removing any legal interest in individual banks, the CBR will restore lost confidence in its role,

and establish a clear line between its regulatory and operational responsibilities.

Recommendation 2: Strengthen Banking Regulations.

Many regulatory procedures for the banking industry are either in draft or don't exist. Russia must provide this guidance as soon as possible. As the number and type of banks increase, regulation become even more important. Regulatory procedures are needed to standardize common banking practices and solve some of the more pressing problems. For example, Russia needs to stem the influence of organized crime into Russian banks and prevent the use of Russian banks to launder money.⁵⁹

Recommendation 3: Modernize Banking Operations in

Russia. Russia needs to significantly modernize its banks — those in major cities as well as smaller banks throughout the country — and encourage banks to adopt international banking standards and practices. The broad objective is to deregulate the banking industry in order to allow greater economic development in Russia. Russia is beginning to create a national electronic interbank payment and transfer system, which will speed business transactions for both the commercial and private banks.⁶⁰ While banks need to introduce or expand “modern” banking services like ATMs, credit/debit cards, and checking accounts, and institute credible accounting and reporting procedures that conform to international standards, the introduction of technology is a small part of building a modern banking system. Finally, Russia needs a federal deposit insurance program to protect investors and encourage saving.

OBJECTIVE 3: Role for US Financial and Technical

Expertise. The United States can assist Russia with the specialized training and technical assistance that the Russian banking system desperately needs. At the same time, banking reform will increase the stability of the Russian economy.

Recommendation 1: Organize, Encourage Private Assistance to Russian Banks and Financial Institutions.

The United States needs to encourage private institutions to organize programs to assist Russian banks and financial institutions. There is a need for training and technical assistance throughout the Russian banking system. The point, however, is that Russia needs technical assistance rather than infusions of government capital.

There are many ways for the United States to provide specialized training and technical assistance to financial and banking institutions. For example, in 1992 about 250 Russian commercial bankers met at a Connecticut university for a five-week conference to study American banking principles. The training was sponsored by the Russian-American Bankers Forum to help Russian bankers modernize their financial systems.⁶¹ Another US program is building a pilot check-processing system in Tula, near Moscow. Because Russia's transportation system cannot support nation-wide check distribution, American advisors are helping to install an electronic record-keeping system for the bank's customers.⁶² These are exemplars of US assistance activities that assist Russia's efforts to build a free market economy.

But there are other kinds of assistance, including the use of advisors and consultants, exchange programs and seminars, transfers of technology, and donations of needed equipment and supplies. Governmental assistance, if managed properly, can be an excellent investment while enhancing stability and supporting US national interests. But the greatest payoffs are likely to be derived from private-sector initiatives that demonstrate interest, open new investment markets, and build business relationships.

OBJECTIVE 4: Promote US Collaboration with Other Countries and Organizations. While unilateral US assistance is important, cooperative efforts with other countries and international organizations eases the burden on the United States and broadens international involvement.

Recommendation 1: Coordinate Banking Assistance Programs With IMF and World Bank. Currently, in conjunction with international financial institutions, the United States is providing technical assistance to Russian bankers and CBR officials using the Agency for International Development (AID) to conduct training for commercial and central bankers. In addition, assistance to Russian banks is coordinated through the IMF, World Bank, and the European Bank for Reconstruction and Development (EBRD). The \$300 million Financial Institutions Development Project targets 21 of the largest Russian banks for loans and technical assistance in exchange for improving their capital positions. The banks, known as "International Standards Banks," have sister banks in the West to provide technical expertise. The project is also aimed at training Central Bank inspectors and helping Russia incorporate international accounting standards.

While these programs help Russia in the early stages of development, vastly more technical assistance is needed to successfully establish a safe and secure banking system. What Russian banks need is mundane support rather than enormous loan packages. In that spirit, further assistance will improve the payments system, bank inspection and supervision, accounting and auditing standards, and deposit insurance system.⁶³

Recommendation 2: Articulate Long-Range Strategy for Banking and Financial Reform. In conclusion, a strong banking industry and economy are critical to the success of democratic reform in Russia. Despite great pressure to make quick improvements, the United States must have realistic expectations about Russia's prospects for success. We remain optimistic that the Russian banking system will improve, but understand that the process will be slow and painful.

Notes

1. See Simon Johnson, Heidi Kroll, and Mark Horton, "New Banks in the Former Soviet Union: How do they Operate?," *The National Council for Soviet and East European Research*, p. 4.

2. See "National Treatment Study: Russian Securities Market, A Report to Congress on the Foreign Treatment of US Financial Institutions," *Office of the Assistant Secretary (International Affairs), US Department of Treasury*, 1994, p. 8.

3. *Ibid.*

4. *Ibid.*

5. See Joshua Chadajo, "The Independence of the Central Bank of Russia," *RFE/RL Research Report*, July 8, 1994, p. 26.

6. See "National Treatment Study," p. 8.

7. See "The Independence of the Central Bank of Russia," p. 28.

8. *Ibid.*, p. 6.

9. *Ibid.*

10. See "The Russian Federation — Banking," 1994, p. 3.

11. *Ibid.*, p. 7.

12. Researchers interviewed personnel from banks in Kiev and found three types of commercial banks have developed. Although the research was conducted in Kiev, the conclusions are applicable to emerging Russian banks as well. See "New Banks in the Former Soviet Union: How do they Operate?"

13. *Ibid.*, p. 8.

14. See "Russian Banks: Overgrown and Underfinanced," *The Economist*, July 18, 1992, p. 84.

15. *Ibid.*, p. 85.

16. See Matthew Stevenson, "Dealing in Russia," *American Scholar*, Autumn 1993, p. 505.

17. Of the 12 banks studied in Kiev, 10 employed fewer than 100 workers. See "New Banks in the Former Soviet Union: How do they Operate?," p. 10.

18. *Ibid.*, p. 14. The "personal knowledge" policy between banks and clients circumvents the default problem somewhat. It is unfortunate, however, that this also prevents many small struggling companies that may be unknown to the banks from getting loans, despite their willingness to pay above-average interest rates.

19. *Ibid.*, p. 13.

20. *Ibid.*

21. See "Russian Banks: A Mess without a Market," *The Economist*, January 8, 1993, p. 107.

22. See Neela Banerjee, "Russian City Gets Little Cooperation From Moscow in Municipal-Bond Sale," *Wall Street Journal*, February 17, 1995, p. A6.

23. See "New Banks in the Former Soviet Union: How do they Operate?," p. 21.

24. See Jeffrey Sachs, "How to Keep the Ruble Off the Rollercoaster," *New York Times*, October 15, 1994.

25. See "Up From the Ruble's Rubble," *New York Times*, October 13, 1994, p. A16.

26. See Sachs.

27. *Ibid.*

28. *Ibid.*

29. See "The Independence of the Central Bank of Russia," p. 30.

30. *Ibid.*

31. *Ibid.*, p. 27.

32. *Ibid.*, p. 31.

33. See "Russian Banks: A Mess Without a Market," p. 107.

34. See "National Treatment Study: Russian Securities Market," p. 11.

35. *Ibid.*, p. 8.

36. *Ibid.*, p. 9.

37. *Ibid.*

38. *Ibid.*, p. 11.

39. *Ibid.*, p. 12.

40. See "Dealing in Russia," p. 507.

41. See "The Banking System: Three Views of Its Purpose," *The Current Digest of the Post-Soviet Press*, May 25, 1994, p. 12.

42. This practice is currently being reviewed by the State Tax Service following a recommendation by the CBR to make bad debts tax-deductible. See "The Russian Federation - Banking," pp. 7-8.

43. This paragraph draws upon ideas outlined by Boris Fyodorov, Deputy to the State Duma. See "The Banking System: Three Views of Its Purpose," p. 12.

44. This paragraph draws on information provided in the Department of the Treasury paper. See "The Russian Federation - Banking," p. 4.

45. Sberbank wants to make the card available to almost anyone. Minimum eligibility requires deposits of at least 100,000 rubles (about \$60) with a nominal

issue fee of 500 rubles. Users pay 0.2 percent of the purchase price, which will be deducted from their Sberbank account 2 to 4 days after the purchase. See "The People's Plastic," *The Economist*, February 12, 1994, p. 82.

46. See "The Russian Federation - Banking," p. 5.

47. See "Russian Banks: A Mess without a Market," p. 107.

48. Each bank was directed to contribute 1 percent of its profits per year into both funds until total reserves equaled 25 percent of its authorized capital. See "The Russian Federation - Banking," p. 9.

49. *Ibid.*

50. See "Russia Weighs Deposit Insurance," *Wall Street Journal*, December 1994.

51. See "Overgrown and Underfinanced," *The Economist*, July 18, 1992, p. 85.

52. See "Russia Forms Financial Watchdog," *Wall Street Journal*, November 8, 1994, p. A19.

53. See Sachs.

54. See "The Independence of the Central Bank of Russia," p. 29.

55. *Ibid.*, p. 32.

56. See Steve Liesman, "Yeltsin's Cabinet Choices Send Conflicting Signals on Reforms," *Wall Street Journal*, November 7, 1994, p. A11, who notes, in addition, that, "The disarray in Russia's government highlighted the complex political and financial challenges Mr. Yeltsin faces as he tries to continue with economic reform amid parliamentary opposition and a mood of disgust among many Russians with the intrigues of his government."

57. See George Melloan, "Good Fences Don't Often Make Good Currencies," *Wall Street Journal*, February 6, 1995, p. A13.

58. See "Up From the Ruble's Rubble," p. A16.

59. See "The Russian Federation — Banking," p. 6.

60. See "Overview of Banking Services in St Petersburg," *American Consulate General Pamphlet*, US Foreign Commercial Service, September 1994, p. 2.

61. See Kelley Holland, "The Russians are Coming — to Banking School," *Business Week*, August 2, 1993, p. 75.

62. *Ibid.*

63. Information from this section on international assistance was extracted from "The Russian Federation - Banking," pp. 11–12.

Chapter 7

Russia's Black Market and Impediments to Economic Reform

by Patsy A. Hughes & Berne M. Indahl

- A. The Problem
 - B. The Current Situation
 - C. Russian Government Must Restrain Black-Market Economy
 - D. Recommendations for Action
-

A. The Problem

Of the many challenges to democratic reform in Russia, the broad criminalization of society is the most ominous. The problem extends not only to felonious behavior, but to illicit activities on the part of many Russian citizens.¹ Perhaps the most direct consequence of diminished government authority following the collapse of the Soviet Communist system is a marked increase in criminal activity, often referred to as the "black market."² Since the early 1990s, Russian criminal organizations have gained control of illegal activities in entire towns, and extorted protection money from Russian as well and Western businessmen.³ Some argue that the black market controls 70–80 percent of private business and banking in Russia.⁴

But how pervasive are these elements in Russia? In the old Soviet era, citizens developed a sub-rosa economy that fueled the nation, provided food, supplemented wages, and provided those scarce consumer products required to keep the Soviet State fed and functioning. Yet, the abruptness of the transition from a Communist to a nascent free-market economy created an underground (or black market) economy that plays an important role in Russian economic affairs. In this climate, it is common for

politicians and diplomats to argue that Russia's economy is on the verge of collapse, given the explosion in black market activities in the private, government, and industrial sectors of the economy.⁵

However, the black-market economy experienced a radical transformation to a large criminal syndicate intertwined with organized crime, employs criminal violence, generates profits from criminal activity, and accordingly exercises control over lucrative sectors of the Russian economy. As a result, Russia's experiment with political and economic reform is threatened by black-market profiteering from privatization, money laundering, involvement with criminal organizations in the United States and Europe, and serious security threats to Russia and its citizens. To understand how organized crime and black market activity threaten the success of Russian economic reform, this chapter examines the "hidden" economy in Russia, and later provides policy recommendations for the United States as it seeks to influence democratic reform in Russia.

B. The Current Situation

1. Black-Market Economy Integral to Russian Tradition

Since Tsarist times, Russian citizens were involved in some form of an underground economy both to ensure their survival and to improve their standard of living. We examine several facets of the underground economic activity in Russian history.

Black Market Integral to Russian Economic Tradition. The origins of Russia's criminal syndicate trace back several centuries, beginning with Russia's experience with economic development, to conflicts between gangs and landowners that were fueled by economic oppression.⁶ With the Communist revolution, the Russian economy was converted from a feudal, serf-oriented system to one of collectivism — in which a central plan allocated goods and services and thus indirectly controlled consumer habits. Spending, while theoretically a consumer choice, was in fact completely dependent upon the availability of goods in state owned

stores.⁷ And it was essentially illegal to work at more than one job, even though actual practice varied given the low wages paid to workers.

In the Soviet era, unreliability became the norm, as raw materials were delayed in arrival, equipment was unreliable, and delay seemed to be the order of the day. Entrepreneurial incentives existed only for authorized "free-market" farmers, and wages were consistently inadequate. Such conditions resulted in reliance on "tolkachi" (pushers or expeditors), who vigorously searched for the supplies and raw materials necessary for production and manufacturing. These "tolkachi" were compensated by exchanged favors, bartered finished products, or payment. As industries engaged in the illegal production of sub-components and other high demand goods to guarantee inclusion in this barter system, inevitably some of these goods were sold by individual workers as a wage supplement. Because high-quality goods were rarely available in state-owned stores, consumers increasingly turned to the underground economy in order to meet their everyday needs.

Theft of raw materials was commonplace in the industrial sector, and even the legal markets (e.g., direct sale of goods by collective farm peasants) depended upon illegal diversion of feed, seed, and fertilizer from state farms, as well as illegal use of state vehicles to transport to market.⁸ Theft of finished products from the collective system became the rule rather than the exception in Soviet society. These practices not only fueled the economy and supplemented the pocketbook but became the basis of the economic system in Russia today.⁹

The very mentality of the Communist system further enhanced the rise of illegal economic activity. If "the end justifies the means" rather than any overall ethical or moral code, then the absence of laws, equal opportunity, trust, and honesty, among others, contributed to a systematic erosion of business practices over the years during the reign of Communism. Thus, it is no surprise to see the emergence of illegal business interests as the norm.

Corruption Endemic in Russian Economy. Russian observers are quite familiar with the corrupt nature of the Communist system. With corruption pervasive for more than half

a century and Russia's leadership inculcated in a system that condoned underground economic activity, how are the Russian people to form a free market democracy when the black market was integral to the Russian economy? We also must wonder how, in this social climate, the sale of state-owned assets or the conduct of business is anything other than dishonest.¹⁰

Furthermore, the basic corruption of the Communist system in the Soviet Union encouraged the development of criminal business enterprises. Government officials quickly discovered that there are vast opportunities for personal gain in activities outside the Central Plan. The ever-increasing participation of government offices in the flourishing underground economic activity led to the term "mafia" being used to describe corruption within ministries.¹¹

Finally, the basic human desire to improve the standard of living for oneself and one's family enhances the role of black market activity because it permits employees the flexibility to hold low-salary level jobs while pursuing profitable activities in the private sector. There is evidence that occasionally high-level state positions are made available as a second income to those willing to pay the "official fee."¹² In effect, the entire economic system — the needs and demands of the labor force, official corruption, consumer demand, the basic human desire to improve one's standard of living — all worked synergistically to promote the rapid development of a black-market economy under the Soviet system.¹³

Perestroika Accelerates Economic Corruption. With a well-developed structure of illegal economic activity already firmly cemented in place in the 1980s, perestroika strengthened the opportunities for the black market to expand its reach, as the formerly illegal accumulation of wealth began to flow into private commerce.

One particularly ominous consequence of accelerating economic corruption is that success in the black market requires the cooperation and support of government officials at all levels. Officials certainly aided the survival of the black market during this period of transition, given the evidence, according to Russian investigators, that a majority of black market sub-groups have

ties directly traceable to the government.¹⁴ The problem, however, is that the intertwining of criminal activity and governmental corruption makes it virtually impossible for ethical entrepreneurs to survive against the competition, yet these are precisely the individuals who are necessary for the development of a free market economy in Russia.

Concentration of Wealth in Black Market Economy.

During the 1980s, economic offenses increased in response to societal need. And the danger is that the black market has penetrated virtually all businesses in Russia, whether large or small.¹⁵ Those participating in the black market are achieving financial success and an unprecedented accumulation of wealth in Russia. During the late 1980s and early 1990s, black-market activity continued to move into new directions, despite the plethora of reform plans and processes. The rate of its increase was extraordinary. By 1991, black-market turnover totaled 110 billion in rubles, while by 1992, this turnover had increased to 2.5 trillion rubles.¹⁶ This dynamic prompts businessmen to simulate artificial shortages of goods in order to enhance the success of black-market activity.¹⁷ For example, when a Russian company closes, there is a simultaneous explosion of black-market activity in that business in order to gain enormous profits.

Difficult to Estimate Effect of Russia's Underground Economy. One problem is that the permeation of the black-market in the Russian economy complicates efforts to estimate its effect on economic reform. While official statistics from the pre-reform era are inaccurate, official accounts of the current state of the Russian economy suggest a disturbing level of penetration. There is reason to believe that some degree of Russia's present economic difficulties are attributable to factors other than the black market or economic reform in general.¹⁸

For example, the statistics which denied inflation by failing to figure in shortages, queues, reduced quality, and black-market factors, were abruptly brought to light now that the previously repressed rate of inflation is reported. It is conceivable that the numbers are more ominous than the economic reality in Russia. One consequence is to assign blame for the current economic crisis

to a brief period of reform. Some suggest that the statistical crisis relates in part to attempts to improve the accuracy of economic reporting accuracy after several decades of unreliability.¹⁹

Additional problems in statistical reporting include the failure to account for the emergence of new private enterprises in Russia. By any account, Russia is experiencing explosive growth in new enterprises. Another factor is that the newly founded openness of Russia's news media may mistakenly describe deterioration as the same problems which haunted Russia for decades. The point we need to highlight is that the statistics and information about the state of Russia's economy may be misleading, and thus present a more fearsome forecast than that which actually exists.²⁰ But independent of how economic data are interpreted, the standard of living for the average Russian citizens is dramatically worse.

2. Explosive Growth of Black-Market Economy Since Perestroika

Despite Russia's history of activity on the black market, nevertheless there was a significant increase in underground activity since Gorbachev instituted the first economic reforms. By 1995, various forms of economic crime dominate the normal and legal ways of doing business in Russia.

Organized Crime. The term "organized criminal group" is defined by the Russian Security Service as any group in which 20 or more persons cooperate in the conduct of illegal activities. Using this definition, according to the Russian Ministry of Internal Affairs (MVD), there are at least 5,700 organized crime groups in Russia today. Consisting of more than 100,000 participants, such groups are credited with having carried out at least 2,500 criminal offenses, including murder, and more than 1,000 incidents of extortion.²¹ And we note that the Cosa Nostra (Sicilian Mafia), while not yet operating formally in Russia, increasingly cooperates with American and Russian crime groups.²² To give some indication of the magnitude of violence that these groups perpetrate in Russia, in 1993 some 200 policemen were killed in

St. Petersburg alone.²³ Such statistics do not include the smaller groups that are active in extortion and smuggling rackets.²⁴

Economic Crime Pervasive. Official statistics document an increase in black-market activity since economic reform was initiated in the 1980s. The Russian press reported that the Ministry of Internal Affairs identified as many as 3,000 "organized criminal structures."²⁵ The problem is that the revolutionary changes in Russia make it virtually impossible to accurately record such changes. As previous economic laws are rescinded and new ones adopted, the definition of just what constitutes the economic crime changed remarkably and continues to be fluid. The entrepreneurship that was illegal in the Soviet era is now encouraged; for example, the private resale of goods is now an acceptable form of entrepreneurship. Meanwhile, however, new economic crimes are being identified as the reform process accelerates, of which tax evasion is a common example. Since many current taxes simply did not exist until several years ago, current crime statistics reflect the effect of new laws.

During the Soviet era, economic crimes were pervasive, yet under-reported by the official Soviet press. Statistics on the extent of black-market activity, such as speculation and theft of state property by employees, were systematically minimized. Thus, it is extremely difficult not only to determine the overall crime rate in Russia, but also to assess how criminal activity impedes democratic reform in the Russian economy. It is possible that less restrictive laws governing economic practices, combined with inaccurate statistical documentation in both pre- and post-reform Russia, have so warped analysis of economic crime that it is not possible to determine whether black-market activity is increasing, decreasing, or remaining the same. Nevertheless, the consensus among most observers is that such crimes are rising dramatically.²⁶

Profiteering From Privatization. The pervasive role of official corruption that was known to exist during the former Soviet era clearly persists in Russia today. The literature is rife with anecdotal evidence that government officials accept substantial bribes, in exchange for permitting criminal groups and individuals

the opportunity to purchase state property offered for private sale. There are allegations that local authorities allow organized crime groups to purchase buildings at rock bottom prices, upgrade the facility, and garner enormous profits after its resale.²⁷ The financial base of organized crime groups is therefore becoming increasingly solid with the direct support of government officials at all levels.

Another area of profiteering for organized crime syndicates involves the purchase of privatization vouchers. Begun by President Yeltsin in 1993, the intent was to permit private citizens to use vouchers to invest in the privatization of formerly state-run enterprises. While roughly 70 percent of state-run enterprises were privatized, the Russian police report that upwards of 81 percent of these converted businesses are controlled by organized crime syndicates.²⁸

Money-Laundering and Western Contacts. Since the early 1990s, the transfer of funds from Russia to the West has reached epidemic proportions. The funds acquired illegally within Russia are easily laundered for transfer out of the country into foreign banks and criminal syndicates. The *Moscow Tribune* reports that, "up to \$8 billion in US dollars has been transferred from the Ukraine to the West over the past three years."²⁹ James Woolsey, former Director of the Central Intelligence Agency, reported that roughly half of Russia's 2,000 banks may be Mafia controlled.³⁰ The evidence is that banks are the major mechanism for money-laundering activities in Russia.

The impact on business and entrepreneurial firms is debilitating on several levels. First, given that the complete absence of constraints on street trading permits uninhibited money laundering, the street vendors who sell goods purchased in the West for resale in Russia are not held accountable for illegal transactions.³¹ A nearly universal problem is that imported items are sold locally for rubles but the merchants are not held accountable for their profits. The second problem is that organized crime syndicates within the West use the resale of goods purchased in the West as a convenient mechanism for laundering their money. Finally, cheap raw materials that are purchased on the

street with rubles are easily exported illegally for resale to organized crime syndicates in the West.

3. Black Market Impediment to Free Market Economy

The pervasive and growing role of black-market activities in the Russian economy constitutes a profound impediment to the Russian people and foreign businessmen who are seeking to build the commerce that is necessary for the development of a free market economy in Russia. Thus, there are several ways in which the black market acts as an impediment to economic reform in Russia.

Crime is Endemic. The demographics of crime demonstrate that it is pervasive and is gaining influence in economic affairs in Russia. We can illustrate this point with several vivid examples. Mafia-like organized crime groups enforce extortion demands with high powered rifles. Stolen American cars are sold in Vladivostok at huge mark-ups by an organized crime group.³² Shoot-outs and mobster tactics have taken on a gangster-like style in many Russian cities. Investigations of organized crime identified 174 Russian crime organizations that are operating throughout Russia and in 29 countries,³³ and involve more than 3,000 "gangs" throughout Russia.³⁴ In St. Petersburg alone, one mafia group controls the farmer's market and money-changing business, another controls the restaurant rackets, while a third is involved in every business.³⁵ Furthermore, there are reports that 20 percent of all foreign business in St. Petersburg is controlled by the local criminal structure.³⁶ Italian law enforcement agencies affirm reports from Russian intelligence sources that the Italian Mafia is heavily invested in Russian economic activities. US officials have issued similar warnings that the Russian mafia is expanding their operations into New York, Florida, California, and other states. The combination of chaos and corruption within Russia creates the world's largest incubator for organized crime.

While there are hopes that the increase in criminal activity will be gradually overcome as "partial reform" becomes "full reform," the countervailing effects of excessive regulation and local efforts

to inhibit entrepreneurship, as well as police corruption in their support of such crime, directly encourage the growth of such offenses. Russian authorities are quick to acknowledge that Russia and the West face a developing crisis as unrestrained capitalism, organized crime, and official corruption take hold in Russia. Meanwhile, the Russian Parliament does not take serious actions to curb black-market activity, despite regular expressions of governmental concern that criminal organizations represent a serious threat to Russian society. Furthermore, efforts to ease the earlier restrictions that symbolized the nature of a totalitarian state weaken the mechanisms that constrain black markets and perhaps encourage their growth.³⁷

Criminal Activity Impedes Foreign Investment. The increase in business opportunities for Western investors who seek to develop business in Russia is not helped by illegal activity. The four current primary concerns are kidnapping, extortion, violence that results from business rivalry, and the ever-present risk of unknowing business or personal association with criminal groups.³⁸

There are no reliable statistics on the actual incidence of such concerns, largely because the Russian Ministry of Internal Affairs statistics do not distinguish between common crime and business-related criminal activity. For example, while the number of reported extortion demands is available, they are not distinguished on the basis of business and non-business incidents. The evidence points, however, to explosive growth in violent acts against Russian businessmen. Murders in broad daylight are surprisingly commonplace in heavily populated commercial areas. *CNN* reported that local law enforcement officials see themselves as fighting a battle which they are destined to lose.³⁹ Primarily trained for traffic enforcement, local police are now confronted with the occurrence of as many as four murders each day, as well as major bombing attacks, every three days.⁴⁰ The evidence is that these violent crimes are directly attributable to business threats by members of organized crime syndicates.⁴¹

In the early days of economic reform, Russian businesses experienced a greater risk than foreign businessmen, but in recent months lucrative foreign-owned businesses are now the targets,

for two reasons. The first is that the expansion of Western businesses in the Russian market is viewed as undesirable competition by those who seek to gain exclusive control of the Russian economy. And the second reason is that take-overs or successful extortion attempts against existing Western businesses provide organized crime groups with new revenue sources almost immediately.⁴² To date, the foreign businesses and joint ventures most vulnerable to the demands for protection money include real estate, services, retail, and entertainment. While the demands for protection involve relatively reasonable sums, the expectation is that as businesses increase in size and profit, there will be corresponding increases in extortion attempts.⁴³

Businesses that refuse to succumb to extortion demands face the quite real threat of retaliation. American businesses have successfully avoided serious retribution thus far, but concerns for safety and the realistic possibility of retaliation persuade many western businessmen to remain silent about organized crime threats or demands. In the case of joint ventures, Russian partners go to great lengths to avoid notifying their counterparts of criminal involvement.⁴⁴

By and large, western businessmen are unaccustomed to the necessity of dealing with criminal elements. While in other countries organized crime was a necessary evil of doing business, in the infant stage of private business development in Russia investors do not have any alternative to dealing with these threats. When a business in Russia is confronted with extortion demands or other organized crime threats, western investors are unsure about the best way to respond — other than to comply with the demands. As Valentin Pavlov, a Russian banker and former Soviet Prime Minister who was influential in the August 1991 hard-line Communist revolt against Gorbachev, argued, "It's impossible to do business in Russia without having contact with them (mafia)."⁴⁵

Black Market Threatens Russian Society. President Yeltsin stated that economic crimes are a direct threat to Russia's strategic interests and national security.⁴⁶ Accordingly, Yeltsin said that, "About 40 percent of all entrepreneurs and two-thirds of all commercial structures have been drawn into corrupt relations...

laundering millions of rubles in income.”⁴⁷ The unsettling reality is that the black market is a way of life for all Russian citizens — farm workers, factory workers, scientists or researchers selling nuclear materials to supplement low wages, and corrupt government officials taking a “slice of the pie.” The fact that the underground economy is trafficking in military equipment, nuclear materials, and resources on the international black-market is a significant problem for Russia and the international community.⁴⁸

Trade in Military Equipment. Russia is witnessing the wholesale disposal of its military resources.⁴⁹ Since the late 1980's, there was a significant increase in the number of thefts from military and weapons manufacturing depots. Illegal production of weapons for sale also increased. Total black-market turnover in 1991 was estimated at 110 billion rubles and in 1992, which when accounting for inflation, involves an estimated 2 to 2.5 trillion rubles.⁵⁰

There are many vivid examples of this problem. In March 1994, two employees of a Russian military unit in Tallinn were arrested for trying to sell an entire consignment of military pistols. Another military person was arrested for theft of military vehicles.⁵¹ Another incident involved the attempted sale of 500 kilograms of high-grade explosives by a Russian non-commissioned officer, which was, “enough to explode the entire World Trade Center in New York City.” In addition, the man had in his possession 12,000 rounds of ammunition, all of which was stolen from a military base.⁵² To cite several examples — in July of 1994, two soldiers were apprehended with 14 grenade launchers stolen from their regiment's arsenal.⁵³ Also discovered missing during an inspection of a military depot in the Leningrad Military District in July 1994 were 22 Kalashnikov sub-machine guns, 34 Makarov pistols, 6 grenades with fuse assemblies, and several thousand live cartridges.⁵⁴ While these cases are insignificant, the volume of traffic in military equipment is symptomatic of a serious problem.

Interested buyers have virtually unlimited access to a wide range of items for sale — missiles and an armored personnel carrier, grenade launchers, rifles, and officer's uniforms and

regalia. All of these are readily available on the streets of the former East Germany, Poland, the Czech Republic, and of course, throughout Russia and the newly independent states of the former Soviet Union. Depots for military equipment now operate as open markets for military equipment and supplies. But not all sales are small or inconspicuous. As one observer wrote, "Since the demise of the Soviet empire, billions of dollars' worth of weapons and raw materials have been exported, much of it illegally and for private gain."⁵⁵

Now that the funding for the military and scientists in the once highly-secret closed cities has eroded to the point where scientists earn less than \$100 per month, the door is open for all potential buyers who offer bargains for everything — from MIG-29 fighter aircraft to strategic metals and highly sophisticated nuclear materials. There are reports that a Russian admiral scuttled his fleet of submarines in order to sell them for scrap.⁵⁶ Many military bases lack the necessary fuel to operate because they are managed as service stations to black-market traders. None of this is altogether surprising when military personnel, scientists, researchers, and factory workers receive little to no pay and sub-standard housing. And much of the evidence suggests that the illegal commerce is done with the full cooperation and knowledge of the Russian Intelligence and Security Service personnel and former Party Officials who command a percentage of the profit.⁵⁷

These examples represent only a small fraction of military equipment that is disappearing from Russian depots to fall into the hands of organized crime rings or international arms traders. A number of these crimes are attributable to efforts by military personnel to supplement their meager or non-existent paychecks. In some cases, military budgets were cut so drastically that soldiers, failing to receive payment for months, turn to theft as a means of survival.

Illicit Sales of Nuclear Materials. One of the more worrisome markets is the sale of weapons-grade nuclear materials. Since the early months of 1994, the situation in Russia continues to disintegrate, as indicated by the number of reports of attempted sales of nuclear materials. While there are many cases in which

cesium and other low-grade radioactive materials are smuggled across the borders, there are credible cases when employees of nuclear fuel research facilities were apprehended with three pounds of highly enriched uranium.⁵⁸

On August 19, 1994, the interception by German authorities of a cache of four kilograms of 87 percent pure plutonium, which was believed to have originated in Russia, involved the third significant seizure in four months. In all, the German authorities have investigated what they believe are 123 cases of people trying to sell nuclear materials smuggled from the former Soviet Union.⁵⁹ This seizure, which was reported as, "the most significant security threat to the West in the post-cold-war era," might have involved enough material to produce a primitive nuclear weapon.⁶⁰

Russian authorities vehemently and steadfastly deny that these materials are being smuggled out of Russia, claiming that all military installations are well guarded.⁶¹ While this might be true for secure military installations, it does not hold true for all the major laboratories and research facilities where the less-than-reassuring security fuels concerns that valuable and dangerous nuclear materials are "leaking" out of these establishments.⁶² The seizure by German officials of plutonium, with an estimated worth of \$250 million on the world black market, serves as a reminder that underpaid or poorly housed scientists can use illegal means to secure reasonable compensation.

There is sufficient evidence of demand for illegal Russian nuclear materials on the international black market. The volume of activity alone constitutes convincing evidence that there are plenty of buyers for these materials. Because it is only a matter of time before sales of black-market nuclear materials fall into the hands of unsavory groups or states, the US Department of Defense is, "focusing on the overall issue as an issue of the highest priority."⁶³

Inadequate Government Vigilance. Amidst the fierce struggle for control over the assets of Russia — including industry, banks, defense facilities, ports, and factories; the transfer of billions of dollars to Western banks in 1993 by organized crime; the expansion of black market and mafia operations to legitimate businesses;⁶⁴ the illegal export of billions of dollars of valued raw

materials — the more ominous trend is the relative indifference of the Russian Government. There are signs that government officials are deeply involved in or acquiesce in organized crime. To take the case of St. Petersburg, there are reports that 70 percent of the police force is corrupt, as cooperation with the mafia encourages the operation of the black market.⁶⁵ Russian regional leaders cooperate with the black market because it helps them maintain local power over resources that are necessary for economic activity. Given their hostile resistance to centralized government control, local government leaders share common interests in cooperation with black-market activities. The consequence is that in this climate, the ability of foreign entrepreneurs to pursue economic ventures in Russia is inhibited. And while bribery is a “given” and extortion demands are common, the Russian legal system offers little in the way of recourse or protection.

Worrisome Consequences for Russia. The continued presence of black market activity presents a particularly menacing problem. With the involvement of officials at every level in government, organized crime in Russia severely threatens economic reform, particularly if it fuels an ultra-nationalistic backlash against current government reform and a return to earlier economic practices. A second problem is that black-market and mafia activity accentuates the shortcomings of free market economic systems. The great danger is that unchecked economic chaos in Russia will foster an authoritarian government that destroys the hope of a stable international order.

At the same time, Western involvement in the Russian economy often facilitates mafia penetration into Western economies, as it builds on partnerships between unsavory Russian businessmen and Western businessmen in many sectors of the Russian economy. Finally, the smuggling of Russian resources can threaten international markets, as exemplified by the flooding of Russian aluminum which is depressing world prices for aluminum.⁶⁶ Broadly defined, the danger is that uncontrolled economic chaos and illegal economic practices will fuel hostility between Asian and Western investors that destroys the hope of a prosperous partnership and stable relationship with Russia.

C. Russian Government Must Restrain Black-Market Economy

Despite the history of black-market activity in Russia and the current pervasive and dangerous explosion of the problem, the Russian government must take steps to alleviate the problem before free-market reform is destroyed. We believe that the black market poses a fundamental challenge to the ability of Russia to transform its economy and political system, and that there are several problems that Russia must circumvent.

No Consensus on Black-Market Economy. There is considerable discordance in Russia about the effect of economic crime on free market reform. Some argue that the apparent increase in criminal activity may be completely false or excessively exaggerated, given that criminal activity today is a relic of criminal activity during the Soviet era. While previous official corruption exceeds the present level, we are witnessing the transformation of the previous state-sponsored black market from monopoly enterprises to small group competition.⁶⁷

Others argue that the existence of "informal economic activity," even if it is illegal, is beneficial to Russian economic reform because it enhances the exchanges that are integral to free markets. When we consider the extensive and radical nature of societal, institutional, economic, and political change in Russia during the last several years, this "informal system" provides a more rapid means of reform than the more formal, albeit unenforceable, approach. Even racketeers, it is argued, provide stability and ensure compliance with contractual obligations with a level of enforcement that the Russian state cannot hope to match.⁶⁸ With this interpretation, the rising crime rate which is endemic in more developed and sophisticated democracies, is an inevitable and material consequence of granting citizens vastly more economic, political, and moral freedom.

However, the third, and in our view the most convincing argument coincides with the view of Russian authorities that the explosion in certain forms of economic crime poses a direct threat to the health of Russian economic reform. The 1992 statistics cite

the fact that an unprecedented 2.76 million crimes were committed; the growth in overt street violence which is attributable to economic crime is more conspicuous and fear provoking to the general population than previous state-sponsored crime; and new entrepreneurs must pay bribes and have physical protection plans to protect themselves and their families.⁶⁹ We believe that the pervasive influence of crime threatens to destroy the Russian economy, cripple political reform, undermine public morale for democratic reform, and endanger lives and property. The point is that the destruction of the Russian societal fabric involves profound risks for Russian, its neighbors, the international system, and ultimately to US interests.⁷⁰

Troublesome Questions. The troublesome question for the Russian people and their leaders is what must be done to ensure the stability of Russian society amidst the increasing incidence of crime. The erroneous belief that a free enterprise system serves as a precursor to a thriving democracy fails to consider the historical dimensions of organized crime in Russia, the scope of the existing black market, and the magnitude of governmental corruption. It, therefore, comes as no surprise that Russia is teetering on the brink of authoritarianism when the fabric of society is threatened by the propagation of crime throughout Russia. Nor will it be sufficient for Russia to revert to the repressive tactics — that served so well and ruthlessly during the totalitarian era to destroy the essence of democratic governance — to restore political and economic stability.

The contradictions within the Russian economy create profound problems. As an example, basic activities that are essential to the success of a free market economy remain illegal, while others, although legal, are unprotected. For example, in Russia the police may arrest and incarcerate a group of felons for criminal acts, but the total absence of Western-style conspiracy and racketeering statutes means that police cannot prosecute the mastermind if the individual is not caught in the act. Necessary prohibitions on criminal behavior (i.e., a criminal code) which undermine such a free enterprise economy do not, as yet, exist.⁷¹

Conclusion. In the past, the Soviet government acquiesced in the development of a thriving underground economy. The social contract as it emerged in the Soviet Union did not penalize the behavior of citizens, who themselves experienced little or no remorse for stealing from the state. The rationale was that because the command economy cannot provide basic raw materials for production of essential consumer goods, citizens were obligated to "fill in the gaps." But with the collapse of the former Soviet Union, the black market in Russia exploded into a multi-million dollar business in which virtually everything is for sale.⁷² But the price of this attitude is that the Russian people may witness the "complete criminalization" of society.

Despite the paucity of good news in the context of criminal activity in Russia, there are some reasons for optimism in 1995. On the positive side, as reform proceeds and as inflation comes under control, a workable tax system is being instituted, and organized criminals are being caught and prosecuted. Some hope that eventually the black market will once again come under control and become a manageable aspect of everyday life in Russia. The greatest challenge to the Russian Government is to establish controls on the more unsavory aspects of the underground economy.

Nevertheless, Russia is mired in problems. The wholesale theft and sale of military property and nuclear materials continue to alarm the rest of the world, and will do so until Russia adequately addresses the looming fiscal problems in the military-industrial complex. The risk that a nuclear warhead or enough fissionable material to manufacture a nuclear device might end up in the hands of irresponsible individuals or governments constitutes a grave concern to both Russia, the successor states and the West. This fact alone warrants the complete attention of the West. Finally, the pervasive nature of economic crime and the black-market in Russia impede the development of democracy as we know it. One of the great dangers is that uncontrolled criminal activity may provoke fascist-style intervention in order to achieve economic stability. While it is important for Russia to deal with the problem of organized crime, it also must modernize the entire governmental system in Russia if democratic reform is to take hold.

D. Recommendations for Action

We believe that the United States must assist in the establishment of democracy and a vibrant free market economic system in Russia. There are several steps that must be taken in light of the growing influence of organized crime in Russia.

OBJECTIVE: Contain Organized Crime in Russia. If Russia is to build a market economy, it must manage the problem of organized crime. To accomplish this, there are several specific steps that the Russian Government must take. While the West can assist in several areas, it is fundamentally the responsibility of the Russian government to combat the epidemic of crime.

Recommendation 1: Develop Racketeering Statutes. As a first step, the Russian Legislature must review and modify existing legislation dealing with economic issues and offenses, and thereby adopt a legal statute similar to the United States federal Racketeering Code (RICO) statute. The Russian government must have the power, as articulated in the Russian Criminal Code, to manage the problems raised by organized crime groups. The adoption of a statute similar to the comprehensive American racketeering (RICO) statute will permit the Russian government to impose severe legal sanctions. If Russian society wants to reduce the incentive for citizens to participate in organized crime, there must be credible sanctions against criminal behavior. The problem, unfortunately, is that Russia's criminal statutes are not adequate to deal with organized crime. On some level, the West can assist Russia with these modifications to legislation. Officials from the United States State Department and Department of Justice are equipped to assist the Russian Duma with the implementation of this legislation.

Recommendation 2: Support Law Enforcement Training. It is important to assist the Russian Ministry of Internal Security with training law enforcement personnel. Russian MVD investigators need to receive advanced training to

prepare them to investigate organized crime cases throughout Russia. Training courses can be taught in the United States, other Western nations, and Russia. The precedent is that such training in law enforcement assistance is provided under existing US Government programs administered to numerous third world countries by the departments of State and Justice. The United States Attorney's Office in the Department of Justice provides courses to train and educate law enforcement investigators in organized crime — for example, specific training in gathering of evidence and preparation of organized crime cases prior to trial.

Recommendation 3: Support Legal Education. It is essential for Russian prosecutors and judges to receive legal education. The hope is to train a new generation of Russian attorneys and judges in the comprehensive preparation and effective prosecution of organized crime cases. At present, individuals in the Russian judicial system do not have the necessary background and expertise for dealing with organized crime syndicates.

Recommendation 4: International Coordination Against Nuclear Leakage. The United States and other states need to worry about the leakage of nuclear materials to states, such as Iran, Iraq, and North Korea. Because there are signs that organized crime groups are involved in potential sales of nuclear weapons and materials, the United States needs to broaden its coordination with the nonproliferation efforts of Russian law enforcement groups. The prevention of the dissemination of nuclear weapons from Russian criminal groups is an important aspect of the American commitment to assist the Russian government negate the spread of organized crime in Russia. Only comprehensive measures will reverse the pattern of nuclear commerce in Russia.

Notes

1. See Andrey Neshchadin, "Russia's 'Grey' Economy," *FBIS-USR-94-111*, October 13, 1994, p. 45.

2. See Michael Alexeev, Clifford Gaddy, Jim Leitzel, *Black Markets, Economic Crime, and Russian Reform*, Washington, DC: The National Council for Soviet and East Europe Research, 1993, p. i.

3. See Daniel C. Diller (ed.), *Russia and the Independent States*, Washington, DC: Congressional Quarterly, 1993, p. 288.

4. See Marshall I. Goldman, "Don't Cry, Wolf: I Was Right," *Wall Street Journal*, November 22, 1994, p. A25.

5. See Stephen Handelman, "The Russian 'Mafiya'," *Foreign Affairs*, March/April 1994, Vol. 73, No. 2, p. 88.

6. *Ibid.*, p. 86.

7. See Alexeev, p. 5.

8. *Ibid.*, p. 3.

9. *Ibid.*, pp. 2-3.

10. See Peter Galuszka, "Red-Handed Russia," *Business Week*, January 11, 1993, pp. 14-15.

11. See Handelman, p. 83.

12. *Ibid.*, p. 84.

13. *Ibid.*

14. See "Yeltsin, Rutskoi Launch War on Crime," *The Current Digest*, Vol. XLV, No. 7, 1993, p. 9; also see Handelman, p. 84.

15. According to one observer, "Virtually all small businessmen have moved into the shadow economy. The 'grey' economy does not pay taxes, does not register and does not document its transactions in a legal manner." See Neshchadin, p. 46.

16. See "Crime Wave, Corruption: What Can Be Done?" *The Current Digest*, Vol. XLV, November 6, 1993, p. 12, while noting that the bouts of inflation in Russia make these comparisons more difficult.

17. *Ibid.*

18. See Alexeev, pp. 6-7.

19. *Ibid.*, p. 9.

20. *Ibid.*, p. 4.

21. See Robert Franks, *Organized Crime Briefing for American Businessmen in Moscow*, Russia, Washington, DC: US Department of State, October 21, 1994. The MVD readily acknowledges the inadequacy of its reporting, and identifies its meager statistics as probably covering only a small percentage of the actual number of criminal groups, as well as the actual number

of criminal acts. Informal sources suggest that a more accurate recording would include as many as three million Russians presently participating in organized criminal activity.

22. *Ibid.*

23. See Kit Vladmirov, "Sweden Attracts Russian Mafiosi," *St. Petersburg Press*, September 27–October 3, 1994, p. 5.

24. See Franks.

25. See Dorinda Elliott, "Russia's Goodfellas: The Mafia on the Neva," *Newsweek*, October 12, 1992, p. 50.

26. See Neshchadin, Handelman, and Franks for useful discussions on the rise of criminal activity in Russia since the collapse of the former Soviet Union. All of these sources provide evidence for the proposition that organized crime activity is on the increase in Russia.

27. See Galuszka, p. 16.

28. See "The Russian Mafia," *Cable News Network (CNN)*, October 24, 1994.

29. See "Attackers Try to Stab Ukrainian Minister," *The Moscow Tribune*, September 22, 1994, p. 2.

30. See Franks.

31. *Ibid.*

32. See Duffy and Trimble, p. 42.

33. *Ibid.*

34. See Elliott, p. 50.

35. *Ibid.*

36. See Rossiyskiye Vesti, "Growing Link Between Foreign Business, Petersburg Crime," *FBIS-SOV-94-063*, April 1, 1994, p. 66.

37. See Handelman, pp. 88–89.

38. See Franks.

39. See *CNN*, "The Russian Mafia," October 24, 1994.

40. See Franks.

41. *Ibid.*

42. *Ibid.*

43. As Mike McCoy wrote in the *St. Petersburg Press*, September 27–October 3, 1994, p. 16, "paying protection money in the city is rapidly becoming

a fixed overhead cost of doing business. In one week in September 1994, local residents filed 1,108 criminal complaints."

44. See Franks.

45. See Margaret Shapiro, "In Russia, The Unthinkable is Becoming Thinkable," *Washington Post Weekly Edition*, October 3-9, 1994, p. 18.

46. See *The Current Digest*, Vol. XLV, No. 7, November 6, 1993, p. 9.

47. *Ibid.*

48. There is a vast literature on incidents that involved the seizure of nuclear materials from Russia and the nuclear successor states. See Mary Mycio, "Ukraine Seizes Uranium Cache; 2 Russians Held," *Los Angeles Times*, March 22, 1995, p. 1.

49. See Kirill Belyaninov, "Nuclear Nonsense, Black-Market, Bombs, and Fissile Flim Flam," *The Bulletin of the Atomic Scientist*, March-April 1994, p. 44. A Russian investigative reporter personally observed a black marketer claim "...There is one more piece, but nobody wants to take it. Too much hassle...in a corner, covered with old rags and gas canisters, stood what appeared to be a nuclear warhead. SS-20 fully assembled. Seventy thousand dollars and you can take it now." See also Brian Duffy and Jeff Trimble, "The Wise Guys of Russia," *US News and World Report*, March 7, 1994, p. 46.

50. See *The Current Digest*, Vol. XLV, No. 6, November 6, 1993, p. 12.

51. See Tallinn, "Russian Military Involvement in Crimes Increases," *FBIS-SOV-94-047*, March 10, 1994, p. 37.

52. *Ibid.*

53. See Vladimir Gondusov, "Police Apprehend Soldiers Stealing Grenade Launchers," *FBIS-SOV-94-127*, p. 39.

54. See Anatoly Yurkin, "'Large' Batch of Weapons Stolen From Depot," *FBIS-SOV-94-132*, July 11, 1994, p. 27.

55. See Jonathan Beaty, "Russia's Yard Sale," *Time Magazine*, April 18, 1994, p. 52.

56. *Ibid.*, pp. 52-54.

57. *Ibid.*, p. 53.

58. See *Nuclear Successor States of the Soviet Union: Nuclear Weapon and Sensitive Export Status Report*, Washington, DC: Carnegie Endowment for International Peace, December 1994, pp. 39-58.

59. See Steven Erlanger, "Russia Denies Nuclear Material is Missing," *New York Times*, August 16, 1994, p. A6.

60. See Tom Masland, "For Sale," *Newsweek*, August 29, 1994, p. 30.

61. See Erlanger, p. 6.

62. See William C. Martel and Steven E. Miller, "Controlling Border and Exports," in Graham Allison, et. al., *Cooperative Denuclearization: From Pledges to Deeds*, CSIA Studies in International Security, No. 2 (Center for Science and International Affairs, Harvard University, January 1993), for the dangers of exports of sensitive nuclear materials.

63. See Thomas Lucey, "Nuke Experts Doubt Russian Plutonium Black Market Exists," *Defense News*, August 22–28, 1994, p. 8.

64. See Elliott, p. 50.

65. *Ibid.*

66. See Handelman, p. 95.

67. See Alexeev, p. 18.

68. *Ibid.*

69. See *The Current Digest*, November 6, 1993, p. 12.

70. *Ibid.*

71. See Handelman, p. 89.

72. See Franks for the argument that "the underground economy has kept the current economic reforms from failure and the Russian economic system from collapse."

Chapter 8

Economic Assistance to Russia: Rethinking the Strategy

by Daniel C. Clark & Dennis J. Jackson, Jr.

- A. The Problem
 - B. The Current Situation
 - C. Propositions About Assistance to Russia
 - D. Recommendations for Action
-

A. The Problem

With the collapse of the former Soviet Union and the disintegration of the economic and political structures in Russia, many in the United States and the West believe that we have an historic opportunity to reshape our former arch enemy. Since the early 1990s, the United States and the West promised billions of dollars to assist Russia's transition to a democratic government and free-market economy. In a plan more ambitious than the Marshall Plan for rebuilding Europe at the end of World War II, the United States, Europe, and Japan pledged support for efforts to rebuild Russia. The hope was to build a democratic form of government and a free-market economy where none previously existed, and do so in the face of economic, political, and social chaos.

Toward this end, Presidents Bush and Clinton promised to provide aid to support a broad spectrum of activities which encouraged democratic reform. The hope was that President Yeltsin's reform-minded government would pursue policies that were consistent with the interests of the United States. The sobering reality, however, is that the once-bright prospects for rapid reform continue to dim. Foremost is the realization that political and economic reform are phenomenon that will require

decades, if not longer as the Russian people cope with the day-to-day struggle of building a new society under harsh economic conditions, systemic corruption, and political chaos.

These are weighty concerns and ones that animate the fundamental choices facing the United States at this moment in history. This chapter examines the strategy for economic assistance to Russia, summarizes the assistance given thus far, examines why the assistance program remains mired in dissatisfaction on both sides, and concludes with questions about the risks for further Western assistance in the face of growing worries about the path of reform in Russia. Finally, we present recommendations for ensuring that US assistance to Russia's transformation to democracy and free markets remains consistent with US interests.

B. The Current Situation

In the early 1990s, the United States and the leaders of the Group of Seven (G-7) nations established an assistance program tailored to aid Russia with its monumental political and economic reform. The components of the assistance strategy are outlined below.

The Assistance Strategy. The fundamental strategy behind the decision to provide assistance to Russia rested on the principle that the West had no choice but to help Russia make the transition to a democratic society. In the case of the United States, the best way to assist Russia was articulated in various policy statements by senior officials in the United States government.¹ The broad theme of US policy is to provide Russia with outside aid to assist its efforts to build a free-market economy after the disintegration of its command economy. President Bush framed this strategy of assistance to Russia in terms of a strategic imperative for the United States. In his words, our obligation is to, "Help democracy and markets expand...where we have the greatest security concerns and where we can make the greatest difference."² The strategy of the United States rests on the twin objectives of making the benefits of reform visible and tangible to the Russian people,

and finding targets for assistance that support economic reform on a permanent basis.

A nearly-universal article of faith among the leaders and the people of the G-7 nations is that they have a profound stake in the success of Russian economic reform. Despite occasional rhetorical flourishes, no one ever seriously argued that assistance from the United States and the G-7 nations derives from altruism or good will. The imperative behind assistance was the strategic belief that democratic and economic reform in Russia was likely to expand markets, ease international tensions, and produce a "peace dividend" at the end of the cold war. In January 1993, President Bush affirmed this principle when he declared that, "We must support stabilization and political reform in...the former Soviet Union [as] our number one foreign policy priority today."³

The greatest challenge for the G-7 nations is to develop a strategy which maximizes the chances that economic assistance from the West will promote and strengthen genuine and substantial democratic reform in Russia. The United States was transfixed by the hope that we could assist Russia in transforming how the Russian people work and think as necessary steps toward building and sustaining a democratic state.⁴ A parallel motivation followed from the deeply-held US hope that we too might be able to divert some resources from defense to other national priorities.⁵ Nor did the United States leadership forget to mention that the cost of the American aid package was justified by the prospect that economic reform in Russia would provide growing overseas markets for American businesses.⁶ In an act of bipartisanship, the Clinton Administration not only supported the overall goals of economic assistance to Russia, but also warned of the dire consequences of failure.⁷

The resources provided to Russia by the G-7 nations included food and agriculture grants, technical and humanitarian assistance, and private sector and government-backed financial assistance. In 1992, Russia stood to receive \$24 billion in economic assistance, which translated into \$18 billion in balance-of-payment funds and \$6 billion dollars in a currency stabilization fund that was to be managed over a three-year period. In 1993 the

Clinton Administration, with the support of the G-7 nations, made further promises toward supporting Russian reform when it disclosed a \$1.6 billion initiative at the Vancouver Summit and a \$28.4 billion assistance package announced at the Tokyo Summit.

Conditions of Assistance. It was recognized from the outset that the provision of assistance to Russia was fraught with many dangers, including the risk that assistance would “leak” out of Russia into overseas banks. Thus, from the beginning, assistance from the G-7 nations was tied to relatively strict terms and conditions for the Russians which were designed to ensure that assistance met the goals established by the donor states. The International Monetary Fund, which acted as the agent for the disbursement of G-7 assistance, imposed strict conditions on the Russian Government. Given the principle that Russia must acknowledge and support human rights for all ethnic and religious groups if it is to establish a democratic state, the G-7 nations emphasized the need to create a pluralistic society that protects the rights of diverse ethnic, religious, and cultural communities. A further principle was that Russia and the Newly Independent States (NIS) had to devise coherent economic programs for moving to a market economy, thus acknowledging that there is no substitute for a firm economic foundation if Russia hopes to join the ranks of the prosperous economies and thereby compete in the international market. The third provision was the thinly-veiled hope that Russia might become, for lack of a more elegant phrase, a “normal society” comparable to the role of Germany as a partner in a cooperative international order.⁸

Early assistance packages sought the cooperation of the Russian authorities to involve the commercial sector in the effort to guide Russia through economic reform.⁹ Those conditions reinforced the American goals of encouraging rapid and sustained comprehensive political reform as well as promoting fundamental transformations in Russia's economy. In a clear and unmistakable case of linkage, Secretary of State James Baker tied US diplomatic and economic assistance to, “democratic political practices, responsible security policies, and free market economies.”¹⁰

Assistance Targets Russian Infrastructure. The initial assistance program for Russia by the G-7 nations envisioned the provision of \$15-20 billion in financial assistance each year for three years in the form of grants rather than loans. The cost was to be shared by the United States, Japan, and various European governments led by Germany, which continues to provide the lion's share of the assistance to Russia. It is important to note that this assistance supports the Russian economic infrastructure — in particular, agriculture, transportation, and communication.

Through early 1995, the G-7 nations provided technical assistance in the form of various training programs to help the Russian society with its transformation.¹¹ Furthermore, the United States Government awarded a \$1.6 million contract to two American companies to provide technical assistance and a \$2.7 million contract to develop voucher and depository functions for a Russian privatization program.

Humanitarian Food Relief and Agricultural Assistance. The original assistance provided by the United States focused on the agricultural sector. Since 1992, the United States Department of Agriculture provided Russia with 63,485 tons of commodities worth \$52.5 million under the Food for Progress Program. Other assistance included a \$250 million food grant to Russia and delivery of 50 grain storage facilities. Along with Agriculture Department assistance, additional agriculture and agribusiness support was supplied through American support programs, including \$66 million in food systems restructuring, a \$645,000 grant to train Russian and Ukrainian farmers, and over 800 US volunteers working to teach the Russians more efficient farming, food storage, and distribution techniques. And the American government supports two private agribusiness centers in Russia through financial and technical assistance.¹²

Medical Assistance. Since 1992 the United States government has attempted to supplement the failing Russian health care system by establishing six hospital partnerships in Russia and donating \$32.9 million in medicine and medical supplies through Operation Provide Hope. Assistance programs sponsored by the private sector in the United States provided over

\$54 million in medical supplies, 8,700 tons of food to 48 locations in Russia, and a \$300,000 grant to set up a maternal and infant health care program. While we note that these medical initiatives are sorely needed in Russia, the problem is that these consist of either one-time donations or a fortuitous side-effect of the reduction of American forces in Europe. Thus, many of the benefits derived from these initiatives tend to be of short duration.

Denuclearization and Defense Conversion. While all aspects of the assistance programs to Russia are important, the denuclearization and defense conversion programs garner the lion's share of the attention. Since 1991 the United States government allocated a total of \$1.3 billion through the Nunn-Lugar Act to help Russia fund the denuclearization of former Soviet strategic forces and begin the conversion of military-related industries to consumer production.¹³ The legislation stipulates that the program should, to the extent feasible, draw upon American technology and expertise for the work required and involve private business in the United States.

In January, 1994, the United States signed an umbrella agreement and other separate agreements with Russia, Belarus, Ukraine, and Kazakhstan to provide over \$550 million in aid.¹⁴ Russia was given \$130 million of specialized equipment in 1993 to dismantle strategic nuclear delivery vehicles. In addition, \$75 million was provided for the purpose of building a storage facility for excess plutonium, while \$10 million was earmarked to establish material controls and physical protection for civilian nuclear materials. While some progress was made in the last few years, differences of opinion regarding US rights to monitor Russian atomic facilities or examine the use of materials slows these efforts.¹⁵

Vancouver, Tokyo, and Naples Initiatives. As a result of the summit held at Vancouver, Canada, on April 3-4, 1993, President Clinton pledged \$1.6 billion in US assistance for Russia. In addition to the \$1.8 billion aid package requested by President Clinton during the April 1993 Tokyo G-7 summit and excluding the FY94 Nunn-Lugar request of \$400 million, this assistance plan totalled over \$2.4 billion. The Vancouver package

primarily concentrated assistance on support for private sector development, trade and investment, the democracy corps initiative, and resettlement costs for Russian troops being withdrawn from Eastern Europe. Although the Tokyo summit aid package mirrored the Vancouver support categories, it promised more aid in different categories. For example, the Tokyo package nearly doubled the \$148 million pledged for private sector development at Vancouver, whereas the security assistance category of \$215 million offered at Vancouver was eliminated entirely at Tokyo.¹⁶ The assistance given to Russia by the G-7 governments includes \$4.1 billion in Initial Stabilization Support, \$10.1 billion in Support for Full Stabilization, and \$14.2 billion for Support for Reform and Imports.¹⁷ At the recent Naples Summit, G-7 leaders promised to tighten the conditions under which aid is provided to Russia. These included new and expanded special drawing rights from the IMF, rescheduled debt payments, greater access to Western markets for Russian goods, aid to fight crime and corruption, and additional aid for nuclear safety.

Discordant Expectations. An important political influence on the Russian assistance program involves the differing American and Russian expectations about the nature of assistance and the hopes for progress. From the beginning, the Russians believed that the United States and the West had the ability to ease the pain of Russia's transition to a free-market economy. By their comments and actions, both Gorbachev and Yeltsin fueled public expectations in Russia that the United States and its allies would supply the money, expertise, and support that they knew Russia did not possess on its own.

But with the passage of some four years since the West made its initial promises of assistance, the Russians are beginning to understand the harsh reality of economic reform. In 1993, the greater part of the money promised to aid Russia was not used, and the same probably will be true for 1994. And to make matters worse, many in the West wonder aloud whether we need to give further assistance to Russia. As one observer noted, "Even Russian democrats now see that the huge investments in the sick Russian economy that were supposed to come out of thick Western wallets

are nothing but dreams. No one in Russia believes that foreign aid will create a miracle.”¹⁸ Worse, there are calls to reexamine assistance to Russia in the face of concerns that Russia might tilt toward a more authoritarian government.

There is broad resentment in Russia about the restrictions that Western governments place on the use of assistance funds, including standards of accountability that are totally foreign to the Russia people and government. While part of the problem derives from the fact that assistance funds were allocated for programs created by Russians to meet American standards, the larger reality is that neither Russian governmental nor nongovernmental organizations were prepared, psychologically or technically, for the kinds of scrutiny that assistance creates.¹⁹ Despite promises of massive assistance, assistance simply will not solve the pervasive social, political, and economic problems that plague Russia in the 1990s.

An additional source of discontent involves the task of developing a reform package that is acceptable to the International Monetary Fund (IMF). As early as the spring of 1992, Boris Yeltsin and Yegor Gaidar presented a proposal to the G-7 for assistance, but much of that assistance has not reached Russia. While G-7 leaders promised \$24 billion in aid and grants in 1992, not even half of the money promised was actually delivered. In 1993, only \$5 billion of the promised \$28 billion in aid made it to Russia, most of that in the form of export credits. The popular skepticism and discontent in Russia with the restrictions imposed on assistance fuels a political debate.

A 1993 plan to provide \$4 billion to help privatize the wasteful and inefficient state-owned enterprises in Russia illustrates why Russia perceives much of Western aid as a political sleight of hand. The plan was for the so-called US “challenge grant” of \$500 million to be matched by the contribution of another \$1.5 billion by our G-7 partners. The United States would then arrange an additional \$2 billion in aid from the international financial community — all of which translates into a long road toward \$4 billion in promised aid.²⁰ And since the money was designed to be used for closing down inefficient industries, it might produce distasteful and

politically unpopular results which have the effect of further weakening popular support for President Yeltsin's government. Thus, Russians were skeptical about Western aid proposals once they understood the strict regulations on the disbursement of assistance funds. Some argue that these Russian frustrations contributed to the surprisingly large vote for radical Russian nationalists in the December 1993 parliamentary elections.

In 1993 Russia also lost access to much of the promised aid by failing to make payments on previous foreign debts that are estimated to be \$80 billion. Part of the problem for Russia is that US aid exists in the form of loans and incentives, not cash, which adds to Russia's foreign debt and restricts the ways they can allocate the assistance. To gain access to additional assistance funds, the Russians must meet rigorous reform targets ("shock therapy"), which weakens political support for the reform program. Further exacerbating the perception of unfairness and insult felt by the Russian people is that an estimated 50 to 90 percent of the money pledged to Russia under some aid contracts is paid to US consulting firms and thus does not contribute capital to Russian firms.²¹

We note, however, that the United States and its G-7 partners have tightened the restrictions on the use of assistance funds for a simple reason. They want to ensure that their assistance dollars are used in an effective and prudent fashion, and believe that the best way to achieve this goal is to narrowly target what Russia receives. A corollary of the strategy is to decelerate the delivery of funds in the belief that Russia does not have the ability to spend these resources in an effective manner.

The reluctance of the Russian leadership to use Western aid to reform their economy choked the flow of dollars from the West. US assistance funding for FY94, which was designated to support "building democracy" in Russia, was \$891 million. This amount was less than 4 percent of what was originally promised in 1992, despite the perception in the United States that Russia faces a deepening economic crisis. The United States proposed only \$900 million in assistance to Russia for FY95, and that number may be further reduced in the Republican dominated Congress which

insists sensibly that foreign aid must better serve US foreign policy interests.²²

C. Propositions About Assistance to Russia

The debate about the merit of assistance to Russia often becomes mired in conflicting interpretations of the value of assistance and its potential effects. We focus on several fundamental propositions about assistance in order to provide a framework for understanding the role of assistance in US policy.

Proposition 1: Russia's Problems Dwarf What Assistance Can Resolve

We often lose sight of the magnitude of reform that is necessary to propel the Russian economy into the twenty-first century. Not only are Russia's economic institutions weak by the standards of other societies, but they lack any coherent conception of what must be done to revitalize Russia's economy. When in the spring of 1990, Gorbachev set out to establish a free-market economy in Russia with the "500 Day Plan," the hope was to build economic discipline and promote the flow of international economic assistance. Many questioned whether outside assistance is adequate to build a democratic, freemarket state from the ashes of a former Communist state.

The problem is that, after 70 years of struggling against the United States and the other Western capitalist powers, the former Communist leaders find it almost impossible to adopt free-market systems. In effect, Russia embarked on a policy of market reform and economic liberalization without any clear conception of what a new Russian state will look like, what its national interests were, or what mechanisms of government are responsible for promoting financial order in the new society. The totally unexpected events surrounding the collapse of the Soviet state created many unrealistic expectations for both Russian and American people. The greater concern is that Russia faces a challenge without historical parallel. However, we must at least raise the question

whether Russia's internal economic problems are so great that they dwarf what can assistance can accomplish.

The political chaos and economic pain associated with the collapse of the former Soviet Union destroyed the essential fabric of Russian society. In reaction to Russia's societal crisis, the political debate is diverted by nationalist and reactionary demagogues who blame a combination of Western treachery and trickery for Russia's problems since the late 1980s. The sheer size of Russia's internal political and economic problems might overwhelm the people who do not yet benefit from Russia's economic reform, who are frightened by rapid change and an uncertain future, and who believe that Russia can return to the security of a strong central government. This creates a recipe for political extremism in an environment that many are willing to exploit. The more profound problem is that it weakens the ability of the Russian people to focus on the challenges of economic reform.

This brings us to the proposition that the solution to Russia's economic crisis never rested on assistance from other states. The problems of a decaying command economy, combined with a population unaccustomed to a competitive workplace, are so extensive that external assistance cannot accomplish what Russia must accomplish on its own.

Despite the inefficiencies of the Russian economy, a more modern economy is beginning to emerge within Russian society.²³ While private entrepreneurs are building a new Russian economy, there are concerns that by the turn of the century the Russian work force may be split into two disparate groups. One is a permanent underclass of unemployed, older workers who are left behind by the rapid changes in society and the economy, while the other is a younger, educated, and risk-taking generation whose growing wealth and power will broaden the chasm between the two groups. As Russia begins the inevitable closure of its more inefficient enterprises, many older workers with limited skills or initiative will not fit into a more demanding private sector. There is a danger that as the free-market economy begins to take root in Russia, workers who cannot adapt will be swept aside by the new

generation of workers. Those workers left behind by the technological and information revolutions may form a pool of bitter, resentful workers who are ripe for political exploitation and upheaval.²⁴

Proposition 2: West Cannot Build Russia's Free-Market Economy

The second proposition is that Russia desperately needs to build an economic culture that encourages free-market behavior, and that the West cannot build that economy for the Russian people. Only the Russian people can develop their own economic values that support economic reform. And because economic reform depends on the Russian people, it can be achieved only when the Russian people decide that a free-market economy is consistent with their long-term national interest.

The great myth of the early 1990s was that the United States and other Western states could produce economic reform in Russia. The United States clearly can provide political encouragement, financial assistance, and business acumen to help Russia make the transition to a free-market economy. But this is not sufficient to reform the Russian economy. The historical fact is that free-market economies are not created spontaneously, but emerge from unique conditions which nourish the values inherent in market economies. The position of the Clinton Administration must be that if we lend money to Russia, the Russians must transform their society and solve their own economic problems. The key to that transformation is the creation of a new economic culture.

Political Frictions. Rivalries between various political parties, factions, and nationalist groups within Russia impede the transition to coherent economic policies and practices. While the disparate factions in Russia may not become economic partners in any formal sense, they must extend their efforts to cooperate before free-market economic activity can begin to show signs of progress. In the case of Russia's relationships with its neighbors, the armed intervention in Chechnya exacerbates fears that Russia will be an aggressive neighbor.²⁵ The political instability that results from

the struggle between Russia's political parties and their widely diverging agendas weakens Russia's ability to manage the political frictions that undermine economic reform. The reality is that political parties and factions in Russia must coalesce on common interests before the government can assume the degree of legitimacy that is the *sine qua non* of economic progress.

Economic Inequality. A free-market economy ultimately rests on the proposition that there are equal opportunities for all people to prosper. An enormous challenge for the Russian government is to reduce the growing opportunity gap between Russia's new class of rich entrepreneurs and the destitute millions. Furthermore, the Russians must establish a minimal safety net to protect those who fall prey to the vicissitudes of economic and political turmoil. The people of Russia must believe that they have a stake in the success of economic reform. Their dependence on the state must be reduced, while they must be encouraged to create a better life in an economy that rewards those who take risks and find opportunities.

Rampant Inflation. While inflation stabilized at less than 10 percent per month during much of 1994, it must be reduced even further. The immediate step for the Russian Government is to stop printing rubles, enforce debt payments between enterprises in Russia, and stop subsidizing outdated and redundant industries. If Russia fails in this endeavor, it will destroy the value of the ruble as a medium of exchange and increase the reluctance of Western governments to extend assistance. We see some tentative signs of progress, as exemplified by the observation of Anatoly Chubais, one of President Yeltsin's economic advisors, that, "In 1992 most of my colleagues did not understand that a high budget deficit causes inflation. In 1993 they doubted this was true; in 1994 they are convinced."²⁶

Legal Impediments to Economic Reform. If it is to attract further investment, Russia desperately needs to build a legitimate system of laws and enforcement mechanisms to replace the morass of bureaucracy, corruption, crime, and daily decrees which make economic ventures extremely risky endeavors.²⁷ While the government during the Soviet era had a well-defined legal system,

the sad fact is that the system was designed to enforce the rights of the state rather than protect the rights of the individual — especially in the domain of commerce. If Russia seeks to promote economic reform, it must engage in broad reforms of its tax and legal codes. The goal must be to assure investors that they can make, keep, and repatriate profits, while erasing the Russian perception that a free-market economy which operates on the basis of the profit motive is a moral or ethical aberration.

Proposition 3: Material Limits to Outside Assistance

The third proposition is that there are fundamental limits to the amount of assistance that states can provide to aid Russian economic reform. Neither the United States nor any other state or combination of states can possibly provide the financial resources that are necessary to rebuild the Russian economy — assuming that it is possible for outsiders to build a free-market economy in another state. We will return to this point.

The simple, yet for some painful reality, is that the United States cannot subsidize Russian economic reform. Although the United States has a strong desire to see Russia join the ranks of the democratic states and thus become a cooperative member of the international community, the United States does not have the ability to financially underwrite Russia's transformation, for several reasons. One reason is that the task is simply too large for a state which for decades neglected to develop its own infrastructure. Again, if external reconstruction is possible, the estimate is that comprehensive economic reform in Russia would involve tens of trillions of dollars over several decades. The West's assistance to Russia is vastly inadequate given estimates that to build a modern infrastructure in Russia involves costs in the neighborhood of \$1-1.8 trillion a year for 20 years.²⁸ We need to recall that the United States economy produced approximately \$7 trillion worth of goods and services in 1994.

A second reason is that western societies, despite their immense material prosperity, have neither the excess capital to rebuild Russia nor the desire to buy Russia's friendship. A third reason is the domestic political complications of providing financial

assistance to Russia. One example suffices: A Clinton Administration proposal to provide \$25,000 grants to former Soviet Army officers returning to Russia from Eastern Europe and the Baltic states for the purpose of building housing met with immediate opposition in a Congress struggling to deal with our own domestic needs.

We believe that the United States and other societies must unburden themselves of the implicit expectation that we can build Russia's economy, or that somehow we are responsible for the outcome of Russia's experiment with democratic reform. The simple and unyielding fact is that we do not have the resources to transform Russia's economy, and even if we possessed such tremendous resources, it is doubtful that we could build in Russia what it took us 200 years to build.

No Consensus on Assistance. Despite the support of two successive American administrations for aid to Russia, there still is no deep popular consensus in the United States for such assistance. The result is an uneven quality to the assistance that is provided to Russia.

There are other disruptive episodes which weaken the ability to forge a consensus on assistance to Russia. Perhaps the most prominent incident, which itself recalls the worst of the former Soviet regime, was the involvement of Russian government agencies in the Aldrich Ames spy case. Many reasonable Americans question the wisdom of giving financial aid to Russia for food and economic development when they continue to maintain a large military and develop new ballistic missiles, aircraft, and submarines.²⁹ The brutal invasion of Chechnya,³⁰ and the sharp differences in US and Russian positions on the Bosnian-Serbian conflict, weaken support in the United States for assistance.

We can see the effects of the debate about assistance to Russia, notably as support in the American leadership for assistance ebbs and flows in the political debate. This debate crystallized in early 1992 when former President Nixon chided President Bush for not seizing the historically momentous opportunity to guide Russia through the travails of political and economic change. Before his

death, Nixon likewise chided President Clinton for taking a timid approach to one of the century's greatest opportunities to build a peaceful future. He favored aggressive assistance for all sectors of the Russian economy, led by the United States as, "The best example of what free enterprise can achieve."³¹

But Nixon's views clearly do not reflect a consensus in American politics. While some argue that the United States needs to take a more passive attitude toward assistance — largely because, "The most important economic contribution the West can make is not assistance at all but access to Western markets"³² — other commentators condemn plans to help Russia as "a formula for pouring American tax dollars into a bottomless pit."³³ The interesting fact is that, while President Bush's and President Clinton's original aid packages survived review by the Congress with only minor changes, 58 percent of the respondents in a March 1993 *Time/CNN* poll opposed any substantial increases in aid to Russia.³⁴ The annual battles to justify foreign aid expenditures in the face of huge deficits and cuts in the defense budget is only exacerbated when the United States attempts to provide assistance to a state which was our enemy for more than two generations. And there is a growing storm in the Congress over assistance to Russia in the face of events that undermine the perception that Russia is moving toward democratic reform.

Inefficiency and Corruption Blemish Assistance to Russia. There is a growing perception that whatever assistance the United States provides to Russia ends up going to waste. As evidence emerges that assistance is funnelled in inefficient ways, often into the hands of corrupt officials and criminals, the United States becomes more circumspect about providing direct financial aid to Russia. While Russians still believe that economic reform and their survival depends on Western help, they also understand that the United States remains reluctant to invest in Russia in view of reports of the diversion of assistance funds. The Russian people recognize that their primitive economic system guarantees that assistance is neither equitably distributed nor efficiently used. It is common

to hear complaints that most Western assistance is funnelled through the Russian bureaucracy and remains in Moscow, rather than being distributed to meet the needs of the entire country. A government official in St. Petersburg affirmed that his region receives only a tiny fraction of the total aid that flows into Russia.³⁵ Still, the United States wants to ensure that economic assistance reaches its intended target.³⁶

Proposition 4: There is a Limited Role for the United States

A fundamental proposition throughout this chapter and the entire book is the belief that the United States can play a positive role in Russia's rebirth as a democratic and free-market state. While later we examine specific actions that the United States can take to assist Russia emerge from its "times of trouble" as a democratic state, it is useful to discuss what the United States cannot do.

The reality is that material aid alone provided by the United States to Russia is highly unlikely in the end to pull Russian society out of its current morass. Nor should we believe that assistance will transform Russia into an ally of the United States. The broad issue, however, is that the political, economic, and technological assistance that the United States provides may significantly increase the chance that Russia will emerge as a productive member of the world community. This hope was presaged at the July 1994 G-7 summit in Naples, when President Clinton and other leaders of the G-7 nations spoke of the possibility of making Russia a member of the "Group of Eight." President Yeltsin, with Clinton at his side, told reporters that, "Russia was recognized as a democratic state," and added that Russia was not asking for money or special treatment, but to be considered equal.³⁷ In a positive sign of changing times, for the first time the G-7 allowed Yeltsin to participate as full member in the summit discussions.

Often those who discuss assistance to Russia become transfixed by the process. The simple, yet unyielding, reality is that the impetus behind assistance to Russia remains the belief in the West

that it is in our collective national interests to see Russia emerge as a strong, confident, and peaceful member of the industrialized world. The rebirth of Russia as a confident, competitive, democratic, and free-market society will complete the greatest ambitions of those who articulated the vision that led to the policy of containment during the cold war. The failure to recognize our interest in Russia's future, or Russia's failure to take advantage of the present opportunity, creates a moment in history that is unlikely to repeat itself in our lives or that of succeeding generations.

D. Recommendations for Action

The United States needs to reconsider the strategy that governs the provision of assistance to Russia during this period of political and economic reform. We offer several high-level recommendations to assist those who are responsible for managing US policy.

OBJECTIVE: Shift US Assistance to Private Sector. The proper avenue for assistance to Russia is through the private sector, for only the world's capital markets have the financial basis to transform the Russian economy. It is evident that government sponsored assistance programs often do not reach the intended targets, and thus tend to waste precious resources. We offer a series of broad recommendations to reorient US policy.

Recommendation 1: Channel Assistance Through the IMF. It is essential for the United States to channel support and contributions through the International Monetary Fund. In September 1994, a American-British proposal recommended giving the newest members of the IMF, including Russia, almost \$24 billion in IMF currency.³⁸ The money is important because the Russian government is relying on \$12.7 billion in international credits, mostly from the IMF, for its 1995 budget.³⁹ However, IMF aid must be tied to ruble exchange rate and deficit targets. Moreover, the IMF money should be used to support a currency

stabilization fund, so that investors understand that Russia retains sufficient currency reserves to stabilize the ruble. US participation and leadership in the IMF is an important mechanism for influencing its policies.

Recommendation 2: Use Governmental Assistance as Last Resort. The United States government must discipline itself to provide assistance only when private sources of funding are not available or appropriate. While there are some functions that only the United States government can perform — such as financial support to remove and secure Russian nuclear weapons — in the vast majority of cases the American government must encourage private sector investment in Russia. For example, the Overseas Private Investment Corporation (OPIC) successfully encourages private investment in Russia and the newly independent states by providing investment funding and insurance to American firms. We believe that the private sector approach is a vastly more efficient strategy for building a market economy in Russia, and is more equitable to American taxpayers. Moreover, private investment is the most efficient way to promote economic growth in Russia's private sector. Finally, we believe that in most cases governments simply are not able to build market economies, because the private sector must take responsibility.

Recommendation 3: Target Russia's Communications Infrastructure. An important consequence of foreign investment is to rebuild Russia's infrastructure. But we believe that the area that will generate the greatest economic and social payoff is to accelerate the development of a modern communications system in Russia. Untrammelled communication with the rest of the world will sever the link with the old authoritarian past and destroy the cultural walls that impede Russia's integration into the global economy. For example, personal computers, fax machines, modems, and fiber-optic networks have the power to destroy the power of the government bureaucracies and build an independent information network, such as that which exists in the modern industrial economies.

Notes

1. See George Bush, "Coordinating Assistance to the New Independent States," *US Department of State Dispatch*, January 27, 1992, p. 57; James Baker, "Supporting Scientists of the Former Soviet Union," *US Department of State Dispatch*, February 24, 1992, p. 126; Warren Christopher, "US Support for Russian Reform," *US Department of State Dispatch*, May 31, 1993, p. 389.

2. See Anthony Lake, "From Containment to Enlargement," *Vital Speeches*, October 15, 1993, p. 16, for the argument that the concepts of "democracy and free markets" are inextricably linked in US policy regarding aid to Russia. See Robert Barro, "Democracy: Recipe for Growth," *Wall Street Journal*, December 1, 1994, p. A8, for the interesting and cautionary case that there is a compelling connection between democratic governments and economic growth. While not claiming a causal relationship, he finds that non-democratic countries which achieved high standards of living — as measured in real per capita GDP, life expectancy, and education — tended to become more democratic over time. The argument in defense of assisting Russia with economic reform is that improvements in the standard of living tend to precede expansions of political freedoms, not necessarily the reverse. And this analysis is significant in view of the objectives and conditions implicit in American aid to Russia. The consequence for US policy is that the United States might better contribute to Russia's economic well-being and political stability by exporting economic ideas — notably property rights and free markets — as the precursor to the development of a democratic state in Russia.

3. See *National Security Strategy of the United States*, The White House, January 1993, p. 6.

4. See George Bush, "Coordinating Assistance to the New Independent States," *US Department of State Dispatch*, January 27, 1992, p. 57, for the balance between hope and pragmatism in President Bush's efforts to create public support for assistance to Russia. As he said, "This is not a democratic crusade; it is a pragmatic commitment to see freedom take hold where it will help us the most...If we can support and help consolidate democratic and market reforms in Russia and the other newly independent states, we can help turn a former threat into a region of valued diplomatic and economic partners."

5. See James Baker, "Supporting Scientists of the Former Soviet Union," *US Department of State Dispatch*, February 24, 1992, p. 126: "The more democracy succeeds...the less America will have to spend to defend itself...and the more we'll have to educate our children, improve our highways, clean our environment, and build a more prosperous future..."

6. See George Bush, "Legislative Proposal to Congress: Freedom Support Act of 1992," *US Department of State Dispatch*, April 6, 1992, p. 263, for the view that, "the growth of political and economic freedom in these states can...provide markets for our investors and businessmen..."

7. See Warren Christopher, "US Support for Russian Reform," *US Department of State Dispatch*, May 31, 1993, p. 389, for the argument that, "If reform fails, and if Russia reverts to dictatorship or collapses into anarchy, the consequences would be appalling. The shadow of nuclear confrontation could return. Our "peace dividend" would be cancelled. Cooperation in foreign policy would vanish. And the worldwide movement toward democracy would suffer a devastating setback."

8. *Ibid.*

9. See "Initiative to Assist the New Independent States," *US Department of State Dispatch*, January 27, 1992, p. 66.

10. See James Baker, "FY 93 Foreign Assistance Request-Partnership for Peace," *US Department of State Dispatch*, February 24, 1992, p. 121, for the argument that, "The nature and depth of [our] relations would depend on continuing adherence to our principles and the fulfillment of the assurances given us."

11. See "US Assistance to Russia," *US Department of State Dispatch Supplement*, August 1993, Vol. 4, No. 3, p. 14. The technical assistance involves professionals who have taken up residence in the CIS, supplemented by visiting advisers and consultants; learning materials, seminars, and workshops; equipment and supplies necessary to begin operations; information resource centers and libraries; exchanges of professional groups; technology transfer; and the publication or broadcast of mass media to educate the population in general.

12. *Ibid.*

13. See Reginald Bartholomew, "US Effort to Halt Weapons Proliferation in the Former Soviet Republics," *US Department of State Dispatch*, February 10, 1992, pp. 89-93. More formally known as the Soviet Nuclear Threat Reduction Act of 1991, the Nunn-Lugar Act initially appropriated \$400 million, which was matched in 1992 and 1993. The Act included not only steps for the denuclearization of the Soviet arsenal, but also provisions which required consultation with Russian and CIS civilian and military leaders to "identify key defense conversion demonstration projects which...include the redirection of weapons scientists to research on civilian projects, conversion of military bases to transportation hubs and industrial parks, and civilianization of the industrial base."

14. See Dunbar Lockwood, "Purchasing Power," *The Bulletin of the Atomic Scientists*, Vol. 50, No. 2, March/April 1994, p. 10.

15. *Ibid.*

16. See "US Assistance to Russia and the NIS," *US Department of State Dispatch*, November 22, 1993, Vol. 4, No. 47, p. 798, for a breakdown of the FY94 assistance (excluding the FY94 Nunn-Lugar request of \$400 million) in the following categories:

	Vancouver Initiative	Tokyo Initiative
Private Sector development	\$148	\$375
Trade and Investment	\$243	\$490
Democracy Corps Initiative	\$48	\$220
Support for troop withdrawal	\$6	\$165
Energy and Environment	\$38	\$125
Humanitarian	\$925	\$135
Security Assistance	\$215	\$0
Other NIS	\$0	\$300
Totals	\$1.6B	\$1.8B

17. *Ibid.*, p. 15.

18. See Leonid Zagalsky, "A Penny for Your Dumas," *The Bulletin of the Atomic Scientists*, Vol. 50, No. 2, March–April 1994, p. 9.

19. See Irina Kozyreva, "American Charity and Russia," *International Affairs*, October 1994, p. 27.

20. See Strobe Talbott, "US Must Lead a Strategic Alliance With Post-Soviet Reform," *US Department of State Dispatch*, May 1993, Vol. 4 No. 2, p. 25.

21. See Alexei Novikov, "American Aid for Americans, Leftovers for Russians," *FBIS-USR-94-031*, p. 81.

22. See Mark Matthews, "New Tensions Strain US-Russian Ties," *The Baltimore Sun*, December 14, 1994, p. 1. Political difficulties between Russia and the United States over policy in Bosnia, the embargo on Iraq, and the aid program were hardened by Russia's invasion of the breakaway Muslim republic of Chechnya. Senator Mitch McConnell (R-Kentucky), chairman of the Subcommittee on Foreign Operations, is representative of those who are skeptical about Russia's long-term intentions. He proposes earmarking more money for other former Soviet republics, presumably at Russia's expense. "I never liked the 'Russia first' approach," he says.

23. See Steve Liesman, "Russia's Economic News: It's Not All Bad," *Wall Street Journal*, November 28, 1994, p. A14, for some signs of limited improvements in the Russian economy.

24. See Patricia Kranz, "The Young and the Ambitious," *Business Week*, need date, p. 128.

25. See Stephen J. Blank and Earl H. Tilford, Jr., *Russia's Invasion of Chechnya: A Preliminary Assessment*, US Army War College, Strategic Studies Institute Special Report, January 1995.

26. See "Success, Sort Of," *The Economist*, April 23, 1994, p. 50, for the view of Anatoly Chubais that progress was being made and that older, more

conservative ministers had changed. An IMF official saw a "growing degree of irreversibility", but no one thinks the Russians are out of the woods yet.

27. See Rudi Dornbusch, "No Sense Throwing Good Money After Bad Rubles," *Business Week*, February 7, 1994, p. 18.

28. See J.F.O. McAllister, "A \$2 Trillion Wish List," *Time Magazine*, December 7, 1992, p. 42.

29. See William C. Martel and William T. Pendley, "Nuke the Denuclearization Campaign," *Wall Street Journal*, February 16, 1995, p. A18.

30. "Russia Pounds Rebel Positions Outside Capital of Chechnya," *New York Times*, March 21, 1995, p. A8.

31. See Richard Nixon, "The Time Has Come to Help," *Time Magazine*, January 13, 1992, p. 27.

32. See "The First Aid Summit," *Time Magazine*, April 12, 1993, p. 32.

33. See "Offering a Helping Hand," *US News and World Report*, April 13, 1992, p. 32. Western Germany is pouring a reported \$100 billion per year into the former East Germany in an attempt to bring its infrastructure up 75 percent of that prevailing in western Germany. The victory of many former communist candidates in the October 1994 elections show that the people of the east are quite dissatisfied with their current condition.

34. See Michael Kramer, "It's the Ruble, Stupid!," *Time Magazine*, March 29, 1993, p. 24.

35. Author interview in St. Petersburg, Russia, September 1994.

36. See Wilhelm Hankel, "The Role of Finance in the Market Economy," *SAIS Review*, Summer-Fall 1994, Vol. XIV, No 2, p. 53. Hankel lays the blame for Russia's continuing economic problems squarely on the doorstep of the Western economic powers. He contends that, "it is the unpardonable lapse of all western development aid givers not to have recognized the dynamic impact a money and credit sector would have in the developing world and to have done little to construct such a sector. With efficient financial sectors at the outset these countries would not only have progressed further in capital formation, real income... [they] would have avoided severe indebtedness to foreign banks and markets."

37. *Ibid.*

38. See "IMF Proposes More Funds for East," *The Moscow Times*, September 27, 1994, p. 15. And while some developing countries attempted to block the aid plan at the annual IMF meeting, the financial assistance should be forthcoming. See "Developing Nations Exert Power, Blocking IMF Aid Plan for Russia," *Wall Street Journal*, October 4, 1994, p. A15.

39. See "Russian Budget Relies on IMF," *Wall Street Journal*, October 25, 1994, p. A13.

Chapter 9

Managing Reform in Russia's Defense Industries: Conversion and Arms Sales

by Jerry L. Levesque & William N. McCasland

- A. The Problem
 - B. The Current Situation
 - C. Why Defense Conversion is Important
 - D. Recommendations for Action
-

A. The Problem

Defense industries dominated Russia's economy almost since the inception of the Soviet Union. In the Stalinist era, the concern was one of confrontation with the hostile and encircling western camp. The wartime industries, which were moved east of the Ural Mountains to continue the production of materiel to overwhelm Germany, was sustained on a wartime footing during the cold war. The Defense Ministries (known as the VPK) had the first claim on material and human talent until that prerogative was seriously questioned during the Gorbachev era. The fact that Russia's defense industries retain a dominant role in the economy impedes political and economic reform in Russia.

The reality is that Russia needs to both reform and downsize its defense sector, but this involves several distinct challenges. One is to privatize and reorganize Russia's defense industries in the same way that all of Russia's industries must be reformed. The sharp contraction of the market for war materiel leaves the defense industry with more capacity than Russia is likely to need in the future. Second, the conversion of Russia's defense industries to produce goods for the civilian market is not developing fast enough

to absorb the growing unemployment of millions of Russians. Third, the drastic decline in Russia's need for defense equipment will not be balanced by growth in foreign arms sales.

In this chapter we examine the problems associated with the conversion of Russian defense enterprises to civilian production, the tendency on the part of Russian officials to believe that arms sales will finance defense conversion, and conclude with several recommendations to assist Russia with defense conversion. It is essential to understand that the relationship between defense conversion and defense sales is an intimate one that directly influences how the Russians think about economic reform and the impediments that they face.

B. The Current Situation

In addition to its vast size, a particular problem for Russia is that during the Soviet era defense industries intentionally were concentrated into closed cities that were built entirely for the purpose of military production. Over 80 percent of the economies of Ekaterinburg and Novosibirsk, for instance, was devoted to defense production, and they represent but two of 70 cities in a similar plight.¹ Nothing in the United States is comparable — Los Alamos is far smaller and the largest defense contractors are located in dense industrial regions that have some opportunity to absorb laid-off workers, albeit at less attractive wages and benefits.

Russia's aggressive move to increase arms exports by winning new customers in markets long dominated by the West is part of a strategy to use the hard currency profits gained from arms sales to help finance defense conversion. In reality, however, this strategy acts as a barrier to defense conversion, for several reasons. First, because the potential for significant growth in Russian arms exports is low, profits are sharply limited and inadequate to fund conversion. Second, this strategy encourages excess production of military equipment and thus the reinvestment of any profits into Russia's military-industrial complex (MIC). Finally, this strategy is self-defeating because an aggressive arms sales policy reinforces the dominance of the defense sector in the Russian economy. The

discouraging fact is that this policy acts as an impediment to economic reform in Russia, hinders defense conversion, and threatens democratic reform.

Perhaps the most serious impediment is that the Russians hold competing views on conversion and the future of the defense industry. Russia's defense industries are seen either as an impediment to economic reform or as the engine of recovery. As long as military strength is an inseparable part of Russia's view of itself as a great power, there will be strong pressures for Russia to retain key industries even if they add to the cost of economic recovery. Plans for the conversion of Russia's defense industries abound — from military production subsidized by foreign sales, conversion to “dual use” (i.e., military and civilian applications) products, conversion to strictly consumer/commercial sector production, to bankruptcy and reorganization. Yeltsin's Deputy Defense Minister, Andrei Kokoshin, places great stock in the idea of conglomerate “financial-industrial” groups capable of capitalizing, producing, and marketing joint-use technology to civil and military customers.² But there is no consensus in Russia on the balance between preserving Russia's defense industries while promoting economic reform.

Background on Defense Enterprises. Russia's defense industries, organized during the Soviet era within the Military-Industrial Commission (VPK), consisted of eight major ministries that directed the nation's military production. Before the collapse of the Soviet Union, these industries employed roughly 7.5 million people in 2,000 enterprises.³ While a significant fraction of these people were not involved in arms production, the vast majority (4.1 million people and 1,600 entities) participated in defense production.⁴ More significant still is that the defense sector represented 20 percent of the Soviet Union's total industrial labor force, 16 percent of gross industrial output, 12 percent (115 billion rubles) of national industrial capital value, and consumed 75 percent of industrial research and development funds. Given the large fraction of civil industry within the VPK, these industries represented half of the nation's civil research effort.

Two years after the collapse of the Soviet Union, the number of people employed by the defense sector shrank by 3 to 4.5 million,⁵ yet the overall expenditures on defense are still from 3 to 5 times proportionally larger than that of the United States military.⁶ The demographics of the defense complex are daunting — half the enterprises in the Moscow metropolitan area and three quarters of those in St. Petersburg were involved in military production;⁷ in 74 of the “closed cities” employment in the VPK exceeded 80 percent of their workforce.⁸ By any measure, this was an enormous investment that deliberately was built with excess capacity to meet potential mobilization requirements.⁹ It was this overcapacity of the Soviet defense industry that first Brezhnev and later Gorbachev hoped to exploit for civilian production.

Decisive Role in Russian Economy. That Russia's defense industries had a history of producing civilian goods and a reputation for being the most efficient industries, made them a natural target for improving the standard of living in Russia. When Gorbachev recognized that the Russian people were dissatisfied with their living standards, he continued Brezhnev's policy of strengthening the consumer sector by accelerating civilian production in defense factories. Gorbachev moved more than 260 plants under VPK management,¹⁰ and by the time of the Soviet collapse, the 2,000 types of consumer goods flowing from the defense industry represented 15 percent of all consumer production.¹¹ In fact, VPK factories produced 100 percent of the civil aircraft, television sets, sewing machines, cameras, and VCRs made in the Soviet Union; 93 percent of the refrigerators, 80 percent of the food industry equipment, and 80 percent of the medical equipment.¹² Despite the fact that the production of consumer goods rose 47 percent by the summer of 1991 over the 1988 levels, Gorbachev's conversion programs were generally discouraging.¹³

1. Illusion That Arms Sales Finance Defense Conversion

Russia's desperate need for hard currency, desire to offset falling demand for equipment by the Russian military, and the

prestige and foreign policy leverage that exports create provide strong incentives for Russia to accelerate arms sales. It is unlikely that, given the intense competition in the international arms market, Russia's internal bureaucratic and production problems, and rising costs of defense production, Russia will be able to use arms sales to generate large profits to subsidize defense conversion. This section examines this complicated problem.

US Export Enthusiasm. Any discussion of Russian arms exports must be understood in the context of US arms sales. While the Clinton Administration calls for the United States to exercise restraint in arms sales, the actions of the United States are hardly consistent with this policy.¹⁴ The government continues to sell arms abroad.¹⁵ The United States emerged from the cold war as the world's number one arms exporter. In 1992, the United States sold over \$13 billion worth of arms to 140 countries worldwide,¹⁶ which accounts for 38 percent of the world's arms markets,¹⁷ and 57 percent of the arms market in the Third World.¹⁸ And the United States will surely remain the leading arms exporter in the short-term given existing contracts for over 50 percent of all newly reported arms agreements.¹⁹ Nor is there any doubt that the great success of American technology during the 1991 Gulf War accounts for much of this success.²⁰

Russian Export Enthusiasm. After years of funnelling arms to Soviet client states, Russia places tremendous emphasis on finding new customers. As one Russian official stated, "we are ready and willing to sell to any country permitted by our government."²¹ Russian Defense Minister General Pavel Grachev personally accompanied a delegation of industry officials to the United Arab Emirates in January 1993 to help seal an arms deal.²² This aggressive arms export policy is supported by President Yeltsin who said that selling arms is, "indispensable to supporting the Russian economy."²³

Soviet arms sales, estimated at an all-time high of \$11 billion in 1989²⁴ fell to \$10 billion in 1990, \$6 billion in 1991 and \$1.3 billion in 1992.²⁵ Estimates for 1993 place Russian arms sales somewhere between \$1.2 and \$2 billion.²⁶ Significant Russian arms transfers during 1993-94 include: 28 MiG-29 aircraft and 10

helicopters to Hungary, defense spares and licenses for production to India, 2 Kilo-class submarines to Iran, 18 MiG-29 to Malaysia, defense spares to Slovakia, and the first 50 of 500 BMP-2 armored fighting vehicles and three transport aircraft to the United Arab Emirates.²⁷ Despite such dismal results, Russian leaders continue to support increasing arms sales and voice very optimistic predictions for the future. Oleg Davydov, Russia's foreign trade minister, believes his country can double its exports of military equipment in 1994.²⁸ The Russian media have forecast arms sales of \$3.4 billion for 1994 and as much as \$6 billion for 1995.²⁹

Russia's strategy is to finance participation by its defense enterprises in international exhibitions, aggressive marketing, and making the most advanced products available for export.³⁰ Russia is offering some very good deals. On the international market a T-82 tank sells for \$2.2 million, a Smerch multiple rocket launcher for \$1.8 million, a BMP-3 infantry combat vehicle for \$800,000, and a MiG-29 fighter for \$22 million — all less than half the price of their Western equivalents.³¹ And Russia is offering pretty good technology.³²

Desperate Need for Cash. The primary reason behind Russia's drive for a large share of the world arms market is the need for hard currency. Cash from arms sales can be used to subsidize the enormous costs of modernizing Russia's decaying industrial infrastructure, converting it from defense to consumer goods, and making the transition from a system of central planning to a market based economy. On the positive side, arms are one of Russia's few globally competitive products. Russia is quite skilled in making military equipment.³³ There are, however, several problems with this strategy. To begin with, between \$5 and \$10 billion in annual income from arms sales will not approach the estimated \$150 billion needed for complete conversion of the Russian defense industry.³⁴ Second, only a few percent of any arms sales income actually is used for conversion given the costs of marketing, research and development, production, and supporting the infrastructure. Third, Russia has not collected most of the money owed from previous arms sales to former client states. For

example, Russia had to write off most of the \$10 billion debt in military equipment owed by Syria.³⁵

Falling Russian Military Demand. As in the United States, orders from the Russian military, which is also in the midst of downsizing, have fallen off dramatically. Russian leaders, especially conservatives, are concerned with maintaining an industrial base capable of supporting future requirements. The Tupolev design bureau stated, for instance, they have no new military contracts and there are concerns for the long-term health of Mikoyan.³⁶ Although most Russian leaders agree that defense spending must shrink to support growth in the civilian sector, arms exports are considered necessary to ensure the survival of a core group of defense enterprises capable of supporting Russia's security needs.

Foreign Policy Leverage. Finally, arms sales are still an instrument of foreign policy that allows the supplier to exercise some leverage over the strategic priorities of the recipient state. During the cold war, the United States and the Soviet Union used arms sales to support trusted allies. In the aftermath of the collapse of the Soviet empire, arms sales hold the potential for continued Russian foreign policy leverage in regions around the world. As one Russian official remarked, "by supplying arms we conduct the state policy."³⁷ In fact, much of the political leverage wielded by the Soviet Union resulted from supplying the military needs of various client states. Today, however, Russia cannot afford to provide these arms at ridiculously low prices. By recapturing a large share of the world's arms markets, Russia hopes that it can recreate some of the greatness of the former Soviet Union, which used arms to strengthen its sphere of influence. Russian leaders have said that earning money through arms sales is better than "begging" for aid from the United States.³⁸ While there is a growing consensus that arms sales offer a solution to Russia's economic problems, the future of Russian arms sales may not be so bright.

Shrinking Markets, Intensifying Competition. Since the end of the cold war, the world's arms market has shrunk. The best estimates are that it peaked at \$43 billion in 1984, dropped to \$38

billion by 1989, and is expected to stabilize at about \$15–20 billion annually for the rest of the decade.³⁹ Many of Russia's arms markets have disappeared; former Warsaw Pact countries in Eastern Europe are looking west for their arms needs as they upgrade to NATO standard equipment. And other former customers, like Libya, Iraq, and Yugoslavia, are under an international arms boycott that Russia is willing to support.⁴⁰ Russian officials estimated that Russia lost \$7.5 billion in sales through observing these sanctions.⁴¹ When President Yeltsin agreed not to sign any new arms sales agreements with Iran,⁴² this removed one of Russia's few steady customers and decreased sales by an additional \$1 billion. The poorer former clients, like Cuba, North Korea and Vietnam, have little cash to purchase Russian arms at market prices. To succeed, Russia must expand its arms trade with the few customers which have money to spend - China and India - and develop inroads into new markets formerly dominated by Western manufacturers.

For the first time, Russian defense enterprises must compete on an equal playing field in the international market place with Western manufacturers. The United States, Russia, France, Germany, the United Kingdom, and China currently control over 90 percent of the arms export market.⁴³ Most Western defense budgets, and consequently their militaries, are also shrinking as a result of the end of the cold war, and the orders for military equipment are down. Like the Russians, Western companies are aggressively pursuing new customers. Western sellers are focusing their marketing efforts exactly where the Russians are looking - Asia and the Middle East.⁴⁴

The alliance system set up by the former Soviet Union also works against Russia. Some nations have a history of dealing with the West and will be hard to persuade to change. Furthermore, the successes of Western technology in the Gulf War creates biases against Russian equipment that are difficult to overcome. The Russians face severe competition from their previous allies. Just like Russia, many Eastern European states and members of the Commonwealth of Independent States hope that arms sales will fund the conversions to market economies.⁴⁵ For example, Ukraine

inherited excess Soviet equipment that it is also offering for sale, as well as the infrastructure to build T-84 tanks and ballistic missiles. Recently, Ukraine established a new center to coordinate arms exports and is pursuing many of the same markets as Russia, namely China, India and Iran.⁴⁶

Many of Russia's arms deals contain agreements for technology transfer and co-production. China is currently negotiating for production rights to the Su-27 Flanker. India is exploring joint ventures with Russian defense enterprises to gain licenses to produce the Su-30, MiG-29, and Su-35 fighter aircraft.⁴⁷ In the long run, such agreements may allow some of the current net importers of arms to become net exporters (or at least to become self-sufficient), thus further reducing markets for Russian arms.

Chaos in Russian Bureaucracies. A significant barrier to expansion of Russian arms sales is bureaucratic infighting among the remnants of the Soviet era bureaucracy. There are simply too many players tasked with organizing and overseeing exports. This was evident when Malaysia expressed an interest in buying MiG-29 fighters and 18 different Russian organizations showed up offering their services in procuring the aircraft.⁴⁸ In an effort to consolidate government exports, President Yeltsin issued a decree establishing Rosvooruzhenie, a state company that will take over the functions of three bodies that previously oversaw Russian arms trade.⁴⁹ Rosvooruzhenie is the only Russian organization that was issued a license by the government to trade in combat material.⁵⁰

To make matters worse, the military is independently selling surplus equipment, and many defense enterprises are dealing directly with customers. Gennadiy Yanpol'skiy, general director of the Ministry of Industry's Defense Industries Department, argued that Russia is unable to develop, "long-term trade relationships."⁵¹ In a July 1993 survey of 140 defense enterprises, 87 percent were dissatisfied with the Russian government's licensing procedures and the complexity of working through bureaucratic foreign trade organizations.⁵² They complained that the licensing procedures took too long and that regulatory documents were changed too frequently. The same Russian "system" that slows the entry of

Western businesses into the Russian consumer economy is likewise frustrating potential arms buyers.

Poor Reputation. Another equally significant problem stems from Russia's inability to provide long-term logistical support to its customers. Recent arms buyers, as exemplified by India, have problems getting maintenance services and spare parts. Russia also fails to provide any significant training or maintenance equipment with the major systems. Nor can any single defense enterprise in Russia provide the entire range of services related to the delivery and operation of armaments.⁵³

In general, Russia must develop a more professional approach to doing business, provide full service for their products, and make their weapons more user friendly. The turmoil in the Russian economy and confusion over defense conversion can only worsen this problem. And it is likely that potential buyers will wonder about the reliability of Russia in the event of a more conservative government or another military coup. Buying major weapon systems, such as fighter aircraft or tanks, represents a long-term commitment by a country. Buyers are reluctant to incur the formidable readjustment costs involved in changing suppliers, including retraining and changes in command and control systems, when support may not exist in five or ten years.

Russian Prices Increasing. Finally, problems in the Russian defense enterprises generated by the collapse of their "special place" under central planning impedes arms sales. While Russia produced military items at very low costs because raw materials, labor, and energy were provided at state subsidized prices, production costs and selling prices are rising to Western levels. And the defense industry no longer has first call on the best laborers and raw materials. As the Russians build a consumer economy, competition for resources will drive up prices; energy prices already are rising.⁵⁴ Furthermore, many component producers for defense enterprises were located in other republics of the Soviet Union. The breakup of the Soviet Union created many "holes" in the military-industrial complex, which the Russians must replace if they are to be independent producers of arms. It can even be said that the Russians do not know what the items

they produce really cost. Once they figure out how to be capitalists, the arms bargains will surely disappear.

A related problem affecting production is the aging infrastructure of their production lines and the lack of skills in the work force. Their scientists may be able to build a high technology prototype, but can their assembly lines mass produce it? Given the poor social conditions in Russia today, their labor force faces a bleak future and will lack any motivation to improve the quality of their work. Many of the best workers are entering the civilian sector as it begins to expand.⁵⁵ The Russians are severely lacking in the computer software development skills that control weapon production in the West. The lack of money reduces state financing for research and development.⁵⁶ These facts bode poorly for future technological developments, and thus one can understand why the prospects for Russian arms sales are so bleak, at least in the near term.

2. Reformation of Russia's Defense Industry

In this section, we examine some of the factors that are shaping the reformation of Russia's and Ukraine's defense industries, including the growing efforts to convert from military to consumer production.

Privatization. Yeltsin's government adopted a rapid pace for privatization once they gained power. Believing that they faced a narrow window of opportunity in 1991, the government embarked on a program to divest state ownership of industries primarily through issuing vouchers of ownership and forming joint-stock corporations. Reaction to the program by regional officials and bureaucrats reflected the loss of power and concerns about the ability of newly private enterprises to furnish essential goods and services. Some officials attempted to stop voucher transfers in open defiance of Yeltsin's decrees. This reaction reached a head with Oleg Lobov, then heading Ministry of Economics, who openly criticized the failure of the voucher system to generate funds for the state's deficit or to produce capital for conversion.⁵⁷

Yeltsin's schedule for the privatization of the defense industry is impeded by the industry's role in Russian national security. The underlying requirement for excess production capacity, which Gorbachev hoped to exploit for increased civil production, was to maintain a wartime surge or mobilization capability.⁵⁸ A Presidential Decree issued on July 8, 1994, called *Reduction of Mobilization Capacities and Mobilization Reserves*, only recently changed this long-standing and expensive policy.⁵⁹

A core of 454 enterprises identified in the fall 1993 as "vital" will remain under state ownership, while the remaining 1500 were released for conversion to joint-stock corporations. By December 1993, 443 had privatized and by spring 1994, it was up to 700.⁶⁰ Privatization to date is characterized more as collectivization rather than privatization, however.⁶¹ Workers and managers end up holding an average of 70 percent of the stock issued, and the government did not start listing candidates for bankruptcy proceedings until March of 1994. According to the terms of Russian bankruptcy laws, 70 percent of state industries qualify as bankrupt, but calculations of their value to debtors specifically excludes "social assets" such as housing in the estimations.⁶² The mechanics for liquidation and capital redistribution are only beginning to appear.

Defense industries are the last to feel the effects of Yeltsin's overall economic policies. Although production fell by more than 40 percent between 1990 and 1993, official unemployment figures had only reached 1 percent.⁶³ The sense of obligation that factory managers feel for their people is part of the problem. For instance, even if workers are not paid, their retention on employment rolls ensures that they are eligible for factory supplied housing. Although divestiture of such "social assets" to local governments is sensible from the business point of view, inadequacies in tax codes have the adverse effect of not providing revenues to local governments. And the effect is to slow this process. Clearly Russia needs new legislation to strengthen the revenue base of local governments.⁶⁴

Defense Conversion Policy. The focal point in President Yeltsin's government for centralized control over conversion policy

is the Russian State Committee for Defense Industry Conversion, now headed by Mikhail Bakhonov. Bakhonov's estimate of the capital requirements for conversion initially was set at 150 billion rubles over five or six years, but this estimate nearly doubled later.⁶⁵ The scale of this investment is beyond what the Russian Government can afford to pay. In November 1993, Yeltsin advocated continued government support for R&D and conversion, but noted that, "the enterprises should have resources to fund their own development and conversion."⁶⁶

The central plan for conversion, announced in December 1993 and developed by the Economics and Defense ministries with participation of 60 major industrial organizations, requires 3 trillion rubles. It anticipates production on the order 1.5 trillion rubles for consumer goods, the creation of 150,000 jobs, and the generation of 500 billion rubles for military personnel. The source of funding is state financing and arms sales, as exemplified by the Presidential Degree in July 1994 which authorized the Ministry of Finance to grant 300 billion rubles of bank credits for conversion programs.⁶⁷ Defense Conversion Advisor to Yeltsin, Mikhail Malei, took a longer view of the estimate in early 1993, when he placed it at \$150 billion over 15 years, which is over 2 orders of magnitude higher than the later government's estimate.⁶⁸ To put these amounts in perspective, \$150 billion represents roughly twice the amount the United States invested in the Marshal Plan, which was \$58 to \$79 billion in 1994 dollars.⁶⁹

The crisis is fueled by the sharp drop in military orders and the questionable solvency of Russia. By May 1994, the Finance Ministry had only allocated 20 percent of the year's defense budget, a third of which is earmarked for conversion projects. Defense production fell 33.4 percent in 1993 and production of those companies which had implemented Gorbachev's conversion programs fell 35.6 percent.⁷⁰

Financial-Industrial Groups. Andrei Kokoshin, First Deputy Minister of Defense and the first civilian to hold such a senior position in the Ministry of Defense, outlined a "National Industrial Policy" to ensure the survival of the defense industries which can be the, "locomotive of Russian economic development."⁷¹

The mechanism is to create "financial-industrial groups" patterned somewhat after Japanese and Korean models. While the details of ownership and the level of foreign investment remain unclear, these horizontally diversified conglomerate groups will be self-sufficient "profit centers" that raise capital through privatization and develop new manufacturing opportunities with an emphasis on exploiting "dual use" military-civil technology. The first of these groups are already registered, and 50-60 should be in existence by the end of 1996 according to Igor Shurchkov, chairman of the State Committee for Industrial Policy.⁷²

US Support for Russian Defense Conversion. The Nunn-Lugar Act is the most important US initiative to date, despite the fact that it originally focused on dismantling Soviet nuclear weapons. Later, however, it was amended to support defense conversion.⁷³ The first contracts for defense conversion were awarded in August 1994 to the State Scientific Research Institute of Aviation Systems (GosNIIAS), the Moscow Scientific Production Association of Machine Building (*NPO Mashinostroyenia*), the Leninets Association, and the Istok State Scientific and Production Enterprise.⁷⁴ Funding for these awards included \$16.8 million in government funds and \$5.3 million in matching funds from US industry for joint-venture partners with the Russian firms. Another \$20 million is earmarked for a longer list of 82 Russian enterprises.⁷⁵ The Nunn-Lugar Act provided \$25 million to support, along with the European Community, Japan, and Russia, the formation of the International Science and Technology Center (ISTC) in Moscow to employ about 600 Russian scientists, engineers and hundreds more technical staff of the former Ministry of Atomic Energy (Minatom).⁷⁶

Ukraine Defense Conversion. A United States-Ukraine Committee on the Conversion of Defense Industry was established in March of 1994.⁷⁷ Co-chaired by a US Deputy Secretary of Defense and the Minister of Engineering, Military Industrial Complex and Conversion of Ukraine, it provides governmental liaison on defense conversion. While the expenditure of Nunn-Lugar funds on Ukraine projects was delayed until Ukraine agreed to the law's conditions at the end of 1993,⁷⁸ projects earmarked for

support include upgrading Ukraine's nuclear power station, \$10 million for an institute in Kiev similar to the ISTC in Moscow, conversion projects for sewing machine and wire production, which all told add to \$40 million.⁷⁹ Ukraine and the United States signed an agreement on space cooperation in November of 1994 during President Kuchma's visit that provided \$350 million in Nunn-Lugar funds out of a total of \$900 million in aid, agreed to cooperate on space research, but did not permit Ukraine to compete for US launches with its rockets.⁸⁰

The priority in Ukraine is to convert the ex-VPK industries inherited from the former Soviet Union into an industrial sector capable of meeting Ukraine's own military needs.⁸¹ Largely out of necessity, joint ventures with Russia are gaining in favor.⁸² In 1992 a conversion program for Ukraine was estimated to require 140 billion rubles, according to Victor Antonov, former minister for Machine-Building, but the program received less than 25 percent of that amount. Meanwhile, Ukraine's defense production declined to only one third the level in 1991.⁸³ But the main impediment for Ukraine is the inability to formulate a coherent policy for conversion. This difficulty is not surprising given the slow pace of economic reform and the absence of an overall national security strategy for relating Ukraine's military needs to domestic resources.⁸⁴

C. Why Defense Conversion is Important

Unemployment. The classic consequence of defense downsizing is unemployment, and in that regard Russia is facing a catastrophic increase in unemployment. Official unemployment figures clearly understate the true situation in Russian industry, largely because it fails to account for "under-employment" that keeps workers on the payrolls but gainfully employs them only a fraction of their time for a fraction of their salary.

In terms of orders and production, there was a two-thirds cut in procurement in 1992 and a lesser cut in research and development funds. And in the following year there was a one-third cut in procurement. The output of Russia's defense industry declined 18 percent in 1992 and 16 percent in 1993. Considering

only the military segment of the former VPK, the changes were a reduction in output of 38 percent in 1992, 30 percent in 1993, and 43 percent in the first half alone of 1994. Weapons production is now only 30 percent of the level in 1990.

The share of civilian production grew from 50 percent to nearly 90 percent over the same time, but this does *not* represent any increase in production. The electronics and conventional munitions industries are particularly hard hit. In 1993 electronics equipment output fell 30 percent in a sector that faces severe foreign competition. Orders for military aircraft in 1993 were just over a quarter the level bought in 1991, and for 1994 the total buy is only 17 aircraft.⁸⁵ For 1995, the military and defense industries were allocated 21.3 percent of the total Russian Federal budget, with procurement and R&D accounting for 26.2 percent. The State Committee of the Defense Industry, which manages Russia's conversion efforts, has a budget of 50.3 billion rubles or less than one percent of Russia's defense budget. By contrast, the subsidies of 582.8 billion rubles to the closed regions are ten times more than conversion programs receive.⁸⁶

Few Defense Conversion Successes. While defense conversion has been a dominant theme in Russian policy since 1988, the reality is that defense conversion falls on the shoulders of individual enterprises. And we note that official defense conversion programs are being abandoned in practice, if not as a matter of government policy. The electronics industry in Zelenograd, for instance, abandoned most of the fourteen approved conversion programs.⁸⁷

The broader concern, however, is that despite considerable interest in reported changes in the Russian defense industry, true "success stories" are scarce. By "success," we mean a financially solvent enterprise, which once produced military technologies but now produces civilian goods for a clearly-defined market, and shows signs that it can sustain itself with civilian production. It is unfortunate, but true, that the vast majority of conversion stories appearing in the West involve efforts to find a market. The reality is that capital assets in the defense sector are not liquid, but are highly specialized and not-easily transferred to other purposes.⁸⁸

What few successes exist involve entrepreneurial activity in expanding markets, as exemplified by providing equipment to the oil and gas industries⁸⁹ or bus and rail equipment for public transport projects.⁹⁰

Nationalist Reactions. The effects of unemployment in defense industries, the drawdown of military personnel, and the loss of Russia's national prestige and international influence exacerbate the dangers of extreme nationalism in Russian politics. The "Weimar Scenario" does not escape attention.⁹¹

There is, however, a pervasive sense in Russia that the West deserted Russia in its hour of need, and that the West is treading on Russian interests. This sentiment is real among average Russians as well as government officials. American financial aid aggravates the reaction of the political right that the West exhibits a patronizing attitude toward Russia.⁹² The feeling among the Russian people is that the United States steers defense conversion assistance in deliberate attempts to prevent Russia from deriving commercial benefit from its technological capabilities. Whether the charges are right matters less than the political effect. The political costs can be damaging, as exemplified by Vladimir Zhirinovsky's claim that defense conversion was damaging Russia. And LDP member and Deputy Speaker of the Duma, Colonel Alexander Vengerovsky, contrasted the export value of military aircraft at \$3,000 per kilogram, with \$1,000 per kilogram for civilian aircraft and raw materials at an average of 20 cents per kilogram when he endorsed Zhirinovsky's position.⁹³ There are similar sentiments in Ukraine.⁹⁴

The Arms Sales Gambit

Russian arms sales ultimately will influence its external relationship with the United States and the West and its internal efforts to build a state based on democracy and free markets.

Tensions in Russian Relations. Russian arms sales are a growing source of tensions with the West. The resumption of sales to boycotted countries like Iraq, Libya, or Yugoslavia would undermine Russia's current policy of cooperating with UN

sponsored boycotts. Furthermore, Russia may be motivated to sell the missile and nuclear technologies currently prohibited by international treaties or agreements. Recently proposed rocket engine sales to India were seen by the United States as a violation of Missile Technology Control Regime restraints on the proliferation of medium and long-range missiles capable of delivering nuclear warheads.⁹⁵ The Russians already have deals with China, India, and Iran to build nuclear plants.⁹⁶

The issue of Russian arms sales is already straining relations with the West. Russians believe that the West is eliminating potential markets through pressure to join the world community in support of international arms boycotts.⁹⁷ Many Russian leaders are sympathetic with the view that the United States is leading a Western effort to keep Russia out of the international arms market and thus dependent on Western aid.⁹⁸

Defense Production Versus Economic Reform. Russia's arms sales policy encourages the defense sector to produce more weapons and consume more capital than Russia can afford given the magnitude of its domestic needs. As long as the allure of arms sales drives Russia toward defense research and development and modernization of the defense industry rather than conversion to civilian production, Russia's economic condition will deteriorate. In reality, enterprises have little incentive to retool and retrain their work force in the face of prospects for arms sales. And we note that the defense sector continues to have a large voice in restructuring the economy.

As long as inefficient defense enterprises are kept alive, it will drain needed funding from the consumer economy and subvert reform in Russia. The trap is that a failure of Russian arms sales to meet the inflated expectations of growing sales leads to the eventual collapse of Russia's defense industrial base. In this scenario, Russian scientists and technology migrate to rogue states that engage in actions contrary to US interests. The black market, already large in Russia, has the potential to become the conduit for the proliferation of nuclear technology and materials, which already makes headlines with the seizures of nuclear material in Germany.

It is unlikely, however, that Russian nationalists and the military will countenance the collapse of Russia's defense sector. There already are signs of dissatisfaction in the Ministry of Defense which reflect a reluctance to give Russia independent access to the arms market.⁹⁹ If the Russian military is awaiting an opportunity to reassert itself, the outcome may be a retreat from economic reform. It also may renew efforts to build a strong state-supported defense industrial sector which is capable of meeting Russia's security needs.

D. Recommendations for Action

OBJECTIVE 1: Support democratic reform in Russia and facilitate its integration into the world economy.

Recommendation 1: Use Nunn-Lugar Funds Only to Dismantle Nuclear Weapons. Using Nunn-Lugar funds to capitalize defense "conversion" programs is inconsistent with defense conversion policies in the United States, ignores the role of similar economic forces in Russia and the west, represents a wholly inadequate pool of capital, and suggests wrongly to the Russians that defense industries can be propped up with government subsidies. The record for US defense conversion programs is, "unblemished by success."¹⁰⁰ If capitalizing conversion projects turns out to be politically irresistible, the private sector should provide a minimum of 50 percent of the capital needed to create a commercial return on the investment.

Recommendation 2: Moderate Opposition to Russian Arms Sales. It is advisable for the West to moderate its opposition to Russia's conventional arms sales. Russia's security concerns require that it retains an independent ability to produce arms. As Russia attempts to downsize the defense establishment, it must rely on arms sales and joint ventures to offset the markedly lower orders from the Russian military. Rather than blanket opposition, the United States needs to focus on opposition to selected sales of advanced technologies (weapons of mass destruction, ballistic

missiles) or to selected nations (Libya, Iraq). We must understand that a collapse of Russia's MIC probably will lead to hardline policies and a weakening of reform.

Similarly, the United States must refrain from using its near "monopoly" status as the world's leading arms exporter to squeeze the Russians out of potential markets. We have the ability to sell arms at very low prices or with generous credits just to corner a market. Arms are one of Russia's few competitive products and will remain so for the near term.

Recommendation 3: Support Joint Civil Scientific Projects. Joint research projects offer a means to provide useful products to society and create limited market skills developed for defense industry. Russia offers truly world-class scientific and technological talents in many areas. Scientific cooperation can provide advantages to both Russian and western societies. These programs are worthwhile, independent of the fact that defense developed technologies may be applied is secondary but quite real, and avoids putting the government into a position of picking industrial winners and losers. It is not advisable for the United States to enter into joint defense production ventures with the Russians. Despite the economic argument supporting buying the most competitive product, nations buy weapons for different ends than, say an environmental monitoring satellite, and the post-Soviet evolution of Russia's national security interest is too early to call.

Recommendation 4: Encourage Consumer Production. The United States needs to encourage Russia to develop non-defense products. The creation of a healthy consumer economy in Russia is the best way to reduce the need to sell arms. Loans, favored trade agreements, and lower tariffs must be designed to assist Russia develop consumer production, and similarly US investment needs to support joint ventures.

OBJECTIVE 2: Downsize Russian Defense Production and Capitalize New Industries. The challenge for Russia is to

maintain a defense industry that is consistent with Russia's needs. At the same time, the United States needs to understand that Russia will not allow its defense industry to disappear.

Recommendation 1: Scale Russia's Defense Production to its Needs. Russia will continue to be self-sufficient in arms production, but its industry is vastly larger than it can afford to maintain. Russia must develop a strategy for arms sales that is based on realistic estimates of potential sales. Russia cannot be economically competitive in the international market if it continues to support more production than it needs.

Recommendation 2: Abandon "Conversion by Command." While Russian defense conversion policy reflects "conversion by command," the evidence suggests that defense industries cannot be converted "by command."¹⁰¹ If Russia's economy will be based on market principles and private ownership, it must understand that the ex-VPK industries cannot be *centrally* planned and restructured even with the infusion of new capital. The hope that foreign military sales will finance conversion did not change the underlying need to downsize Russia's defense industry. Russia must promote new business and stop managing the defense industries as a special case. Because government conversion programs are driven by production, not market demand, Russia does not gain long-term economic benefit by sustaining unprofitable enterprises.

Recommendation 3: Establish social safety net for displaced defense workers. The Soviet tradition of full employment and factory support for the social infrastructure runs deep enough. Russia needs to recognize that unemployment exists, and not to obscure the problem with hidden taxes and dispersing underemployed workers in uncompetitive industries. By creating safety nets for unemployed workers, the government can account for the cost and size of unemployment as it develops policy and programs. Education and training, housing support, relocation assistance, and employer incentives are elements of social safety

nets in the Western economies. By assembling an appropriate mix of these for Russians, the government alleviates one of the worries of defense industries who must shrink the size of their enterprises to fit the market. Unemployment is likely to become chronic and intractable for the next generation, but the burden of the unemployed affects all of Russian society and not simply individual enterprises.

Recommendation 4: Russia Needs Contractual Relationship between Government and Defense Industries.

A western-style contractual relationship between customers and suppliers is a basic component of calculating the cost of goods and services. The Russians need to adopt simple performance based specifications for the equipment they procure, allow for overhead to be spread on an activity-basis (program specific), and use acquisitions to exploit the overcapacity in Russia's defense industry. Competition, with full and true cost accounting, will expose the better value supplier, and the government may wish to entertain the option of dual-sources to retain the level of competition over the long haul.

Recommendation 5: Use Defense Industries to Build National Communications and Transportation Infrastructure. Programs to modernize communication and transportation will improve the long-term economic health of Russia and provide new opportunities for former defense industries and foreign capital. These industries have the technical skills to produce the equipment that Russia needs to modernize the society. Furthermore, Russia might as well benefit from the subsidies paid to these industries by having the firms produce useful consumer products. The Russian government must view itself as a major customer of these high-technology services which create opportunities to gain a return on investment.

OBJECTIVE 3: Limit Proliferation of Weapons Technology. The challenge for Russia, as well as other states, is to limit the spread of advanced weapons and technology, thereby

reducing the potential for arms races in the Third World, while sustaining the ability to produce military equipment that is consistent with Russia's interests.

Recommendation 1: Demonstrate Restraint in Arms Sales. Russia needs to show restraint in selling arms on the international markets, continue to honor international boycotts, and be a full partner in United Nations led efforts to control the flow of certain advanced technologies. Russia must emphasize the export of defensive weapons like surface-to-air missiles and air defense aircraft. And it needs to consider how an arms sales will affect the regional balance of power as well as be willing to sell less advanced models or to deny a sale when it is viewed as threatening to neighboring states.

Recommendation 2: Russia Must Participate in Efforts to Create Transparency in International Arms Sales. Russia needs to participate in conventional arms trade talks aimed at making arms sales transparent and verifiable. Russia must demonstrate a willingness to agree to declare all arms sales and to submit to international verification, perhaps with United Nations inspectors. The experiences with inspections under the INF and START nuclear arms control treaties provide evidence that such confidence building measures do work. Such openness might allow the United Nations to monitor the flow of arms to the Third World and take early steps to control them, thereby discouraging secret arms build-ups and reducing the overall flow of weapons.

Notes

1. Steven Erlanger, "Russia's Workers Pay Price As Military Industries Fade," *New York Times*, December 3, 1993, p. A1.
2. Julian Cooper, "Transformation of the Russian Defence Industry," *Jane's Intelligence Review*, Vol. 6, No. 10, October 1994, p. 446.
3. Herbert Wulf estimated global defense industry employment peaked in the mid 1980s at 16 million, and noting claims by Igor Khripunov that the VPK employment reached 8 million, speculated that 16 million on a global basis may

be low. See David Silverberg, "Global Trends in Military Production and Conversion," *The Annals of the American Academy of Political and Social Science*, No. 535, September 1994, pp. 122–130.

4. See Julian Cooper, *The Soviet Defense Industry, Conversion and Economic Reform*, New York: Council on Foreign Relations Press, 1991, p. 12.

5. Keith Bush, "Aspects of Military Conversion in Russia," *RFE/RL Research Report*, Vol. 3, No. 14, April 8, 1994, p. 31.

6. See Kenneth L. Adelman and Norman R. Augustine, "Defense Conversion: Bulldozing the Management," *Foreign Affairs*, Spring 1992, p. 31. Also see Julian Cooper, *The Soviet Defense Industry, Conversion and Economic Reform*, New York: Council on Foreign Relations Press, 1991, p. 21, which notes that the remnants of the former Soviet Union's defense complex are geographically confined largely to Russia, which has three quarters of the total defense plants and roughly 90 percent of the "end item" plants. By contrast, Ukraine possesses 14 percent, Belorussia 2 percent, and the remaining 8 percent is distributed in the other republics.

In the case of Ukraine, 1,840 enterprises employing roughly 2.7 million people were inherited from the Soviet Union. Of the defense factories that produced both military and civilian goods, roughly 700 enterprises which employed 1.3 million employees were dedicated to military production. All told, this accounted for about a third of Ukraine's GNP, 28 percent of the industrial sector of the economy, and employed 18.6 percent of all industrial employees by 1990. Highly interwoven with Russian industries, plants in Ukraine produced half of the USSR's total in tanks, missiles, military optical and radio communications systems, half of all combat vehicles, and a majority of combat ships at the Nikovaev shipyards. Ukraine's defense industries are concentrated in the east and south, which along with that region's concentration of ethnic Russians, generates the strongest base of support for opposing Ukrainian nationalism and restoring ties with Russia. For background, see Taras Kuzio, "Ukraine's Military Industrial Plan," *Jane's Intelligence Review*, Vol. 6, no. 8, August 1994, p. 352.

7. Aleksei Yablokov, "Disarming Soviet Industry," *World Press Review*, August 1992, p. 42.

8. See Cooper, *The Soviet Defense Industry, Conversion and Economic Reform*, p. 22, for some demographic data on the magnitude of the defense sector. The city of Novosibirsk in Siberia, one of the closed cities, had a total population of 1.5 million. And in terms of total employment in defense, the top cities in descending order were Ekaterinburg, St. Petersburg, Moscow, Nizhniy-Novogorod, Perm, Moscow oblast, Kuibyshev, Novosibirsk, Tatarstan, and Udmurtia.

9. See William S. Ritter, Jr., "Soviet Defense Conversion: The Votkinsk Machine-Building Plant," *Problems of Communism*, September-October 1991, Vol. 40, No. 5, p. 53.

10. See Adelman and Augustine, p. 32.

11. *Ibid.*

12. See Cooper, *The Soviet Defense Industry, Conversion and Economic Reform*, pp. 38–39.

13. See Steven Gallant, "The Failure of Russia's Defence Conversion," *Jane's Intelligence Review*, Vol. 6, No. 7, July 1994, p. 303.

14. See *A National Security Strategy of Engagement and Enlargement*, The White House, July 1994, p. 12, for the statement that "Arms control is an integral part of our national security strategy. Arms control can help reduce incentives to initiate attack; enhance predictability regarding the size and structure of forces, thus reducing fear of aggressive intent; reduce the size of national defense industry establishments and thus permit the growth of more vital, nonmilitary industries; ensure confidence in compliance through effective monitoring and verification; and, ultimately, contribute to a more stable and calculable balance of power."

15. See Barbara Opall, "Study: US Still is No. 1 Arms Exporter," *Defense News*, September 5–11, 1994, p. 5, for reports that the United States government recently sent 75 military personnel and 25 military aircraft to an air show in Singapore to help American defense companies influence potential buyers to purchase US weapons. Also see William D. Hartung, "Sale of the Century: Bill Clinton's Amazing Arms Bazaar," *Commonweal*, May 20, 1994, p. 14, for the statement by Secretary of Commerce Ron Brown to a group of US defense company executives that the administration would "work with you to help you find buyers for your products in the world marketplace and then we will work with you to help close the deal."

16. See Richard F. Grimmett, *Conventional Arms Transfers to the Third World, 1985–92*, Washington DC: Congressional Research Service, July 19, 1993.

17. *Ibid.*

18. *Ibid.*

19. See "International Arms Sales: Race to Disaster," *The Defense Monitor*, 1993, p. 3.

20. Buyers want to buy the best weapons available and many consider US military equipment to be the best. In addition, American companies have a good reputation for after sales service through providing maintenance, training, and spare parts. They are also able to offer buyers attractive financing, and often can count on government credits to spur sales.

21. See interview with Major General Sergei Karaoglanov, "The Jane's Interview," *Jane's Defence Weekly*, February 6, 1993, p. 32.

22. See Robert Lowry, "Russia Strives to Make Its Mark," *Jane's Defence Weekly*, February 13, 1993, p. 46.

23. See Konstantin Sorokin, "Russia's New Look Arms Sales Strategy," *Arms Control Today*, October 1993, p. 9.

24. See Yuri Laskin and Alla Glebova, "Russian Defense Sales: The Insider's View," *Military Technology*, December 1993, p. 48; see also Grimmett, *Conventional Arms Transfers to the Third World, 1985-92*.

25. See Clifford Gaddy and Melanie Allen, "Dreams of a Salesman: The Russian Drive to Increase Arms Exports," *The Brookings Review*, Fall 1993, p. 38.

26. See Edwin Bacon, "Russian Arms Exports: A Triumph for Marketing?," *Jane's Intelligence Review*, June 1994, p. 296.

27. See "Arms Transfer Tables," *Defense and Foreign Affairs Strategic Policy*, November-December, 1994, pp. 21-23.

28. See Steven Gallant, p. 306.

29. See Igor Khripunov, "Conventional Arms Control Initiatives: Russia as a Special Case," *Arms Control Today*, December 1994, p. 11.

30. See Laskin, p. 44.

31. See Christopher F. Foss, "Cut Price Weapons Challenge Western Sales," *Jane's Defence Weekly*, April 3, 1993, p. 12. For poor buyers, the low prices outweigh the risks of dealing with the Russian arms suppliers. Most equipment is available for immediate delivery, since many of Russia's defense enterprises have continued to produce even though demand has dropped. Also, the rapid drawdown in the Red Army, resulting from the break-up of the Soviet Union and limitations imposed by the Conventional Forces in Europe arms control treaty, has left a large inventory of surplus weapons that Russia will gladly sell at bargain basement prices. Russia is also offering generous interest rates and will even accept barter in other goods in exchange for military equipment. The latter could prove disappointing when the Chinese for example, paid 50 percent of the cost of the Su-27 aircraft they bought with poorly manufactured goods, tea, and coffee the Russians could not use or resell. See also Laskin, p. 49.

32. The latest MiG-29 and Su-27 compare very favorably to the F-16 and the F-15; the Russian S-300 air defense system is thought to be superior to the Patriot; and the Smerch multiple rocket launcher is considered to have greater firepower and a more advanced fire control system than the US Army's Multiple Launch Rocket System (MLRS).

33. As one Russian writer argued: "We build better tanks, while they make better VCRs. So why should we invest millions into conversion, which would be an additional burden on our people? It could happen that we would forget how to manufacture good guns, and wouldn't learn to make good VCRs either." See

Stephen Blank, "Challenging the New World Order: The Arms Transfer Policies of the Russian Republic," *The Journal of Slavic Military Studies*, June 1993, p. 244.

34. See Laskin, p. 45.

35. See James Bruce, "Russia/Syria Sign To Smooth Arms Trade," *Jane's Defence Weekly*, May 14, 1994, p. 3.

36. See interview with Colonel General Piotr Deinekin in "The Jane's Interview," *Jane's Defence Weekly*, May 7, 1994, p. 32.

37. See Stephen J. Blank, "Russia Arms Exports and Asia," *Asian Defense Journal*, March 1994, p. 9.

38. See Foye, p. 62.

39. See SIPRI, *SIPRI Yearbook 1993: World Armaments and Disarmament*, Oxford University Press, 1993; see also Ethan B. Kapstein, "America's Arms Trade Monopoly," *Foreign Affairs*, May/June 1994, p. 15.

40. See Andrei Martov, "Russia's Asian Sales Onslaught," *International Defense Review*, May 1994, p. 54.

41. See Paul Beaver, "Russia Chases a World Market," *Jane's Defence Weekly*, March 6, 1993, p. 29.

42. See James Bruce, "Russia Agrees 'Arms Sales to Iran' Ban," *Jane's Defence Weekly*, October 8, 1994, p. 2.

43. See "International Arms Sales: Race to Disaster," p. 6.

44. See Barbara Opall, "Price Becomes Paramount in Fighter Sales," *Defense News*, September 5–11, 1994, p. 1. The United States has the capability to under price the competition, including the Russians, and has shown some determination to do so. For example, Lockheed and McDonnell Douglas are currently engaged in a price war over international sales. They are cutting prices for F-16 and F-18 fighters by reducing their profit margins in an attempt to gain market share. Lockheed has reportedly offered the F-16 to Singapore for as little as \$15.6 million. Also see Barbara Opall, "Pentagon Uses Loophole to Gain Edge in Foreign Sales," *Defense News*, August 29–September 4, 1994, p. 22, for reports that the Pentagon is selling AMRAAM air-to-air missiles at lower prices through direct commercial contracts, vice Foreign Military Sales, by using a loophole in the law that allows them to avoid charging research and development costs.

45. See Laskin, p. 49.

46. See Taras Kuzio, "Ukraine's Arms Exports," *Jane's Intelligence Review*, February 1994, p. 65.

47. See Pat Cooper and Vivek Raghuvanshi, "India Eyes Su-30, Mig-29 as World Market Entree," *Defense News*, October 3–9, 1994, p. 1.

48. See Laskin, p. 41.

49. These are the Russian state foreign trade union, *Oboroneksport*; the state foreign trade company, *Spetsvneshtekhnika*; and the Main Administration for Collaboration and Co-operation, GUSK. All three of these agencies fell under the Ministry of Foreign Economic Relations. See Bacon, p. 268.

50. For a detailed description of the evolution of the bureaucracy controlling Russian arms sales, see Charles C. Peterson, "Moscow's New Arms Bazaar," *Orbis*, Spring 1994.

51. See Peterson, p. 283, for the argument that, "The fact that today the developer and producer are virtually excluded from determining the clauses of contracts and their deadlines reduces our chances of making sales and prevents us from building long-term trade relationships. So far the ancillary corporations of the Ministry of Foreign Economic Relations that serve as brokers carry out their activity in isolation from the developers and producers. We propose to work directly with the customer, anticipating his requirements."

52. *Ibid.*, p. 289.

53. See Laskin, p. 41.

54. See Bacon, p. 269.

55. Author interviews in Moscow, September 1994. One of the directors of a test institute described his troubles attracting new engineers and scientists from universities in Russia.

56. See Bacon, p. 269.

57. See Lynn Nelson and Irina Kuzes, "Coordinating the Russian Privatization Program," *RFE/RL Research Report*, May 20, 1994, pp. 15-25, for reports that Moscow's mayor, Yuri Luzhkov, described the privatization policies of Anatoli Chubais, chairman of the State Property Management Committee, "as a crime against city management." But since Yeltsin replaced Lobov with Igor Gaidar, formerly Yeltsin's chief economic strategist, they have not turned back.

58. See Julian Cooper, "Transforming Russia's Defence Industrial Base," *Survival*, Winter 1993-94, Vol. 35, No. 4, pp. 154-155.

59. See Julian Cooper, "Transformation of the Russian Defence Industry," *Jane's Intelligence Review*, Vol. 6, No. 10, October 1994, p. 446.

60. *Ibid.*, pp. 446-447.

61. See Keith Bush, "Conversion and Privatization of Defense Enterprises in Russia," *RFE/RL Research Report*, April 29, 1994, Vol. 3, No. 17, p. 20.

62. See Brian Davenport, "Russia's Bankruptcy Law: Restructuring or Liquidation?," *Defense Conversion*, Stanford, CA: Center for International Security and Arms Control, January 29, 1994, No. 3, p. 1, pp. 1-2.

63. See Keith Bush, "Aspects of Military Conversion in Russia," *RFE/RL Research Report*, April 8, 1994, Vol. 3, No. 14, p. 33.

64. See Cooper, "Transformation of the Russian Defence Industry," p. 447.

65. See Adelman and Augustine, p. 35; Steven Gallant, "The Failure of Russia's Defence Conversion," *Jane's Intelligence Review*, July 1994, p. 304.

66. See Gallant, "The Failure of Russia's Defence Conversion," p. 306.

67. *Ibid.*

68. "Swords and Ploughshares," *The Economist*, January 16, 1993, p. 52.

69. The United States invested \$13.15 billion in then-year dollars from 1948 to 1952 to support the reconstruction of sixteen nations in Western Europe. The Consumer Price Index ratio between 1950 and 1994 is 6.0, and the Producer Price Index is 4.2, which produces the range of \$58 to \$79 billion in current-year dollars. An interesting comparison is to consider that the \$13 billion expended through the Marshal Plan was equivalent to 1.6 percent of the gross domestic product (GDP) of the 16 western European nations (the total for 5 years), which rose 32 percent from \$120 billion to \$159 billion during the five years the plan was in effect. The Central Intelligence Agency estimated that the 1993 GDP of Russia was \$775.4 billion (assuming a 12 percent annual rate of contraction). See Michael J. Hogan, *The Marshal Plan*, New York: Cambridge University Press, 1987; *CIA World Fact Book*, Washington, DC: Superintendent of Documents, 1994.

70. See Paul Beaver, "Russian Industry Feels the Cold," *Jane's Defence Weekly*, May 7, 1994, p. 30, for reports that orders for new equipment were cut by 67 percent from 1993, and remaining procurement plans include only 17 aircraft, 7 percent of Navy's shipbuilding requests, and armored vehicle production that will use only 10 percent of total capacity.

71. See Cooper, "Transforming Russia's defence industrial base," *Survival*, p. 150.

72. See "Current Issues Panel Eyes Financial-Industrial [SIC] Groups," *FBIS-SOV-94-206*, October 25, 1994, p. 16.

73. See John Deni and Dunbar Lockwood, "U.S. Begins to Deliver Nunn-Lugar Equipment to Russia, Belarus," *Arms Control Today*, Vol. 24, No. 4, May 1994, p. 21. The Department of Defense reported to House Foreign Affairs committee that as of March 23, 1994, only \$113 million of the FY92 \$1.2 billion authorized had been obligated, but DoD intended to obligate \$400M more by the end of FY94 and \$400M more in FY95. Funding to date provided for transportation blankets for atomic weapons and commitments outstanding include

almost 43,000 fissile material storage containers by 1997. Assistance in building a storage facility at Chelyabinsk for plutonium weapons "pits" is agreed in principle, but inspection agreements are stalling the \$75 million so earmarked.

74. See Jeffrey M. Lenorovitz, "U.S.-Russian Teams Get Pentagon Funds," *Aviation Week & Space Technology*, August 8, 1994, p. 27.

75. *Ibid.* The funded joint ventures are Rockwell/GosNIIAS to produce a satellite based Air Traffic Control net; Double Cola Co and NPO Mashinostroyeniya to establish soft drink bottling capability; Hearing Aids International/NPO Istok for personal hearing aides; and International American Products and Leninets will produce new dental chairs and related dental equipment.

76. The ISTC provides long-term career opportunities and initial projects funded at \$11.9 million include nuclear safety environmental protection. See Deni and Lockwood, "U.S. Begins to Deliver Nunn-Lugar Equipment to Russia, Belarus," May 1994, p. 21.

77. "Joint Statement on Economic and Commercial Cooperation," *Weekly Compilation of Presidential Documents*, March 7, 1994, Vol. 30, No. 9, p. 437.

78. See Lockwood, "Purchasing Power," *The Bulletin of the Atomic Scientists*, p. 10.

79. See Taras Kuzio, "Ukraine's Military Industrial Plan," *Jane's Intelligence Review*, Vol. 6, No. 8, August 1994, p. 354; Deni and Lockwood, "U.S. Begins to Deliver Nunn-Lugar Equipment to Russia, Belarus," *Arms Control Today*, p. 21.

80. See Paul Mann, "U.S., Ukraine Sign Space Pact," *Aviation Week and Space Technology*, Vol. 141, No. 22, November 28, 1994, pp. 26-27.

81. Author interviews in Kiev, September 1994.

82. See Taras Kuzio, "Ukraine's Military Industrial Plan," *Jane's Intelligence Review*, Vol. 6, No. 8, August 1994, p. 355.

83. *Ibid.*, p. 352.

84. *Ibid.*, p. 353.

85. See Julian Cooper, "Transformation of the Russian Defence Industry," *Jane's Intelligence Review*, p. 445.

86. See Mark Galeotti, "Decline and Fall — The Russian Defense Budget," *Jane's Intelligence Review*, Vol. 6, No. 9, September 1994, p. 386.

87. See Cooper, "Transformation of the Russian Defence Industry," pp. 445-446, for a description of various problems: lack of money, weak demand for non-military goods, uncertainty about future defense funding, and the constraints imposed by the mobilization law that requires full production within

24 hours. More importantly, official conversion funding was not adequate to recapitalize any meaningful segment of the factories, and commercial banks are reluctant to finance long-range recapitalization because they prefer investments that are more clearly defined and offer faster returns on the investment.

88. As an example, the Central Aerohydrodynamic Research Institute (TsaGi) in Zukovsky, a formerly closed city 50 kilometers southwest of Moscow, has a vast combined thermal-vacuum and structural loads test chamber for the Buran space shuttle that was used for an experimental wire annealing process. Author interviews at TsaGi, September 1994.

89. See "Russian-Kazakh Gas Deal," *Wall Street Journal*, February 13, 1995, p. A10.

90. See Cooper, "Transformation of the Russian Defence Industry," p. 446.

91. It was, after all, a combination unemployment and frustrations with the loss of national prestige that toppled the Weimar republic in Germany and led to the ascent of Nazi Germany. Nor is there, of course, a Treaty of Versailles and the accompanying reparations that the Russian people could blame — as did the Germans after World War I.

92. See Adi Ignatius, "U.S. Stirs Russian Resentment with Plans for Defense Conversion," *Wall Street Journal*, September 19, 1994, p. A10, for an example of this sentiment. "It was our absolute last choice, everyone is laughing at us," was the reaction of Mr. Postnikove, head of the Almaz imagery satellite program at NPO Mashinostroyenia, when the United States announced that Double Cola Company, of Tennessee, was selected to form a joint venture with his company to produce soft drinks under Nunn-Lugar sponsorship.

93. Igor Khripunov, "Delusions v. Conversion," *Bulletin of the Atomic Scientists*, Vol. 50, July 1994, pp. 11-13.

94. See Kuzio, "Ukraine's Military Industrial Plan," p. 355, for reports that the radical right party, Ukrainian National Assembly, advocates the establishment of a "Ukrainian Association of Manufacturers Engaged in the Sphere of National Security" to pressure the government to adopt policies of weapons export rather than defense conversion.

95. See Blank, "Russia Arms Exports and Asia," p. 74.

96. *Ibid.*, p. 75.

97. See Martov, p. 50.

98. To cite one Russian official, "Experience shows that the American administration has often attempted to force unwanted competitors out of third country markets, using political methods disguised as export control requirements." See Peterson, p. 280. Various government and military officials in Moscow accuse the United States of blocking Russian arms exports for purely

competitive reasons. Author interviews in Moscow and St. Petersburg, September 1994.

99. See Peterson, p. 288.

100. See Adelman and Augustine, p. 37.

101. *Ibid.*, p. 39.

Appendix on Defense Conversion

This appendix examines briefly several defense conversion projects in Russia as exemplars of the problems that Russia faces in managing the downsizing of its defense industry. While these examples are not meant to be representative, we believe that they capture the essence of the problem of defense conversion in a society that spent roughly 50 percent of its economic resources on defense production.

Saratov Aviation Plant. The Saratov Aviation plant, which is located in a formerly closed city 500 kilometers south of Moscow, provides insights into the issues of privatization and the hopes for conversion. The plant now produces the Yak-40 and the Yak-42, the latter a 120 passenger tri-jet. Their future hopes hinge on development, western (FAA) certification of airworthiness, and sales of the updated Yak-42M.¹

The plant was initially purchased from the state by a 250 million ruble loan and later distributed to the workers in the form of 46.5 million shares of joint stock. The majority of the stock, 190 million shares, was retained in a trust for the purpose of future sales to employees, and for bonuses, incentives, and pensions. But the process of incorporation, defining the rights of stockholders, and establishment of the institution (such as board of directors) and principles (fiduciary responsibility to the stockholders) of corporate operations was hindered by the absence of a legal structure or confidence in civil court proceedings for redress of any nature.

The production of Yak aircraft continues, but the collapse of central supply is the single largest problem faced by plant management. The engines are produced in Ukraine, whose suppliers are seeking payment in hard currency. Worker retention is low, with a 30 percent turnover in the first three years. One difficulty relates to the problem of establishing that the plant is a desirable place to work, as exemplified by the 25-year wait for plant housing. Finally, management has not established ways to balance labor among projects, create employee loyalty down to the very lowest levels of the organization, and build the flexibility to restructure in response to demand for new products.²

Votkinsk Machine-Building Plant. The Votkinsk Machine-Building plant was selected as an exemplar of early conversion efforts under Gorbachev given its role with the SS-20 ballistic missile.³ As the producer of the SS-20, -23 and -25 ballistic missiles, this plant highlighted two significant structural challenges to defense conversion — what some call “pathologies of central management” — that characterize all defense conversion efforts in Russia.⁴

The first is the complete absence of any clear relationship between the price of production and the price of goods delivered. Depending on the production line, anywhere from 60 percent to 80 percent of the billed cost of a missile was allocated to fund the subcontractors, despite the fact that the subcontractors received direct funding from the Ministry of Defense. Furthermore, overhead expenses — such as O&M for the dedicated rail link and security forces — were funded not by the ministry responsible for the plant, but by the separate ministries responsible for railroads and for state security further dispersing any accounting of total cost.⁵

The second is the “command system” for the supply of materials throughout the civilian as well as military production lines at Votkinsk. Although this guaranteed that the plant would receive high priority in the supply system, it effectively disconnected engineering and production decisions from market forces. Thus, although over 5 million baby carriages were produced by this plant, no one knew what the true cost of production for these simple items were. While nobody is seriously expecting to sell enough baby carriages to provide jobs for the estimated 13,500 employees at the plant, they also make some of the most sophisticated numerically-controlled milling machines in Russia. These machines are large and sophisticated, have a lucrative international market, but until Votkinsk can determine what its production costs are and find a commercial distribution outlet, this hope for conversion remains a hope.⁶

Joint Ventures with Foreign Firms. Joint ventures with foreign firms offer a means to exploit Russian technical expertise at Russian labor rates while taking advantage of western capital,

marketing, and sales functions. Over 300 joint ventures exist involving former VPK industries with output in 1993 of \$500 million. Electronics assembly with imported parts, for instance, relies strongly on South Korean participation.⁷ Sun Microsystems is involved in a joint-venture with 10 percent interest in a spinoff corporation called ELVIS+ in Zelonograd located 25 miles north of Moscow. The Russian host firm made space communications hardware and the objective of ELVIS+ is a wireless communications link for Sun's family of work-stations.⁸ Pratt and Whitney is involved in a joint venture with Ilyushin to produce an FAA-approved Ilyushin airliner with P&W engines. Lockheed's largest venture with the Russians is the Lockheed-Krunichev-Energia International project to market launch capability. Allied Signal and the National Institute of Airborne Avionics Equipment at Zhukovsky have formed a venture to develop and produce an integrated suite of avionics for small transport aircraft.⁹ The Central Aerohydrodynamic Research Institute (TsAGI) at Zhukovsky, provides yet another view into the state of conversion. TsAGI had 10,000 workers in March 1993, and prior to 1992, over three-fourths of its work was direct support to defense projects.¹⁰ It negotiated contracts with both Russian and western aviation companies for conducting testing, and plans to complete privatization this year. Several independent technical joint ventures were spun off, including self sufficient "profit centers" for some traditional social enterprises as well as administrative functions.

Notes

1. See Kathryn Hendley, "Steps on the Road to Privatization: Preliminary Report on the Saratov Aviation Plant," *A Project Status Report of the Center for International Security and Arms Control*, Stanford University, CA, June 1992, p. 2.

2. *Ibid.*, pp. 4-16.

3. See Ritter, p. 46.

4. *Ibid.*, p. 51.

5. *Ibid.*, p. 49.

6. *Ibid.*, pp. 57-58.

7. See Cooper, "Transformation of the Russian Defence Industry," p. 446.
8. See "Enterprise Profiles," *Defense Conversion*, Stanford, CA: Center for International Security and Arms Control, January 29, 1994, No. 3, pp. 8–9.
9. "Perry Outlines Plans to Aid Russia Defense Conversion," *Aviation Week & Space Technology*, March 28, 1994, p. 63.
10. See John Battilega, "Enterprise Profiles," *Defense Conversion*, Stanford, CA: Center for International Security and Arms Control, March 29, 1993, No. 1, pp. 8–9.

Part III

Democratic Reform of Military and Foreign Policy

Chapter 10

The Democratic Transition of Russia's Military

by James H. Slagle

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- A. An Institution in Crisis
 - B. Coercion, Patronage, and Russian Military Authority
 - C. Conclusion
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A. An Institution in Crisis

The Soviet Union's military strength was its principal claim to superpower status. When Russia inherited the weapons and strengths of the Soviet military, it also acquired the inherent faults and weaknesses of a military structure involved in societal upheaval.¹ The disintegration of the Russian military is cause for concern given the recent demonstration of combat ineffectiveness and questions about civilian control.² The fact remains that the Russian military controls vast resources and has the ability to threaten neighboring states in the region, intimidate the near abroad, and through its 27,000 nuclear weapons, hold the United States and other states at risk.

The recent employment of Russian military forces in Chechnya give rise to speculation that their forces are ineffective, disorganized, demoralized, and unresponsive to civilian control. But it is dangerous to read too much into these actions. Many of the problems could be traced to poor decisions from Moscow that forced military action before the proper forces could be brought to bear and at a time of year inhospitable to military action. Concerns about the political leadership in Russia, rules of engagement, the use of newly conscripted troops, and overall control of forces all highlight serious problems in the Russian military. A military

establishment which once consumed almost half of Soviet economic wealth has weakened to the point where a simple intervention disintegrated into a bloody and indiscriminate rampage that threatens to tear apart Russia and fuel resistance in Chechnya. The risk is that the frictions and frustrations revealed by the operation in Chechnya may impede democratic reform, strengthen those within the military and security forces who call for a return to the old ways, and "distract" the military from reform.³

The Russian military remains a powerful force in domestic politics. For years its strength was a source of pride to Russia and it bolstered Russia's claim as a world. Now, however, its diminished strength and undefined role threatens to rupture the social contract that binds it to society. The military no longer serves the security needs of its society, and the Russian people have become reluctant to support their military, a situation similar to, but much worse than, that faced by the United States military in the wake of the Vietnam debacle. In this period of social and political upheaval, the military can be a force that supports democratic reform, or it can undermine the hopes for democratic reform with a return to repression and authoritarian rule. The United States has no choice but to care deeply about the transformation of the Russian military. Even in its weakened state, the military is too large, powerful, and influential to be ignored.

In this chapter we examine the underlying problems affecting the Russian military and offer recommendations to make the military more cohesive, responsive, and supportive of democratic reform. When we discuss the Russian military, our goal is not a military sufficiently strong that it ventures outside its sphere of influence, or that it would directly challenge the United States. Our motivation is to strengthen the ability of the Russian military to support democratic reform in Russia and reestablish their ties to the people.

B. Coercion, Patronage, and Russian Military Authority

The Russian military remains tied to coercive methods and patronage as its authority, loyalty, discipline, and training are formed and reinforced at several levels.

1. Military Training: Indoctrination, Hazing, and Patronage

Military Indoctrination. A fundamental element of the Russian military is enforced loyalty and discipline through fear and intimidation, an attitude built upon the basic relationship of the individual and the military. So long as the individual's duty to the state was primary, and there were plenty of capable individuals available, treatment of the individual was not a concern. Human talent was a commodity to be used, not an asset to be nurtured and developed. Whereas in Western militaries professionalism has come to be equated with ability and responsibility, no matter the rank, this is not the case in Russia where position and authority are still the most important measure of worth.

Out of this attitude grew *molodye* and *stariki* ("the young and the old"), the way the military introduces the conscript to military service. From the day the recruit enters the military, he is subjected to a demoralizing sociological phenomena designed to mold conscripts into compliance through a rigid system of authority. This system of discipline, control, motivation, and training within the ranks depends on peer harassment and pressure through which more senior recruits (second year soldiers) physically and mentally abuse the new recruits.

Soldiers in their first year of service, the *molodye*, are quickly indoctrinated into a system that requires subservience to the *stariki*. The older soldiers are given the privilege of establishing working conditions within the unit, doling out privileges, and enforcing discipline. The young soldiers, immersed within a new and threatening environment, soon develop loyalties to the *stariki* who offer the only source of guidance and protection. They also are quickly taught that they too will eventually graduate into the ranks of the *stariki*,⁴ which will bring many privileges.⁵

It is common for young conscripts who challenge this system to meet with physical violence. Victims of this abuse are often forced to relinquish personal items, conduct unpleasant and menial duties, and suffer verbal and physical assaults. This violence can

be so severe that it often results in death, leading to recent public complaints about this form of hazing.⁶ Nevertheless, the problem of violence that clearly is tolerated by the senior ranks of the Russian Army and is a significant source of friction within the military.⁷

Officers and NCOs encourage the *molodye/stariki* system. Most officers are graduates of military schools who participated under a similar seniority system which encouraged respect for authority and position. Their training as technicians, not leaders, neither prepared them to question the system nor exercise authority over and responsibility for their troops. The *molodye/stariki* system gives officers and NCOs a familiar and readily accepted method of enforcing discipline controlling the new *molodye*, while excusing officers of the requirement to become involved.⁸ Typically, Russian officers exhibit a negative attitude toward enlisted soldiers. Officers not only ignore the abusive discipline meted out by the *stariki*, but enjoy the fruits of an enormous gap between the standard of living for officers and enlisted. Officers, in some cases, treat enlisted personnel like serfs, requiring them to perform personal domestic duties.⁹

The overall effect of this harsh system of discipline and the gap between officers and enlisted undermines the authority of the Russian leadership and weakens the credibility of the military in Russian society. Although the system may have been well-suited to the authoritarian style of government under communism, it is totally inappropriate in a democratic society.

Ethnic Frictions and Social Barriers. Historically, the source of manpower within the Russian military consists of conscripted teenagers who are quickly grouped into social clusters.¹⁰ Ethnic Russians, the majority of the members recruited for service, normally gravitate into groups from their particular locale — Muscovites with Muscovites, Volgograd conscripts with fellow conscripts from Volgograd, and so forth. These clusters within the military groups form on the basis of ethnic identification, and units within the military are sometimes isolated due to linguistic differences. The result is that conscripts carry strong

regional feelings, often manifested in tensions between conscripts of dissimilar ethnic backgrounds.¹¹

Because the Russian military recognizes that nationalism or regionalism can cause problems when military troops are sent to quell local disturbances, most conscripts are assigned in distant republics, separated from their home region. The purpose is to ensure that cultural affinity will not prevent soldiers from performing their military duties, however odious.

Under Gorbachev, as the governments of the newly independent states became more independent, the policy of extraterritorial placement was criticized largely because ethnic differences no longer served the purposes they once had.¹² Instead, the ethnic and social biases within the Russian military were clearly exposed for their divisive effects, rather than their operational benefits. The origin and education of conscripts determine the type of unit to which they are assigned.¹³ Not only is education an important status symbol in Russia — a rural education is of lower status than education from industrial areas — differences in ethnicity, region, and education are the basis of new soldiers' social clusters and unit assignment. This basic system of recognized seniority control (*molodye* and the *stariki*) coupled with the ethnic and regional cliques, leads some to preferential assignments (previously to duty with front-line units in Eastern Europe), while individuals with lower status or from less reliable groups are sent to less important, remote locations. Thus, units of prestige and importance often contain a larger percentage of ethnic Russians than, say, a Tajik unit.¹⁴ All of these assignment practices have a corrosive effect on the Russian military.

Revival of Religious Practice. Military authorities during the Soviet era did not allow the display of religious beliefs among military personnel. While there is no evidence that religion is exerting control in the Russian military, the general increase in religious activity in Russia has implications for the military. For now, the overwhelming majority of inductees are atheists, but the resurgence of religion, notably the Russian Orthodox Church, in Russian society and politics is likely to have some influence on the military.¹⁵ The solution in the past was to place suspected religious

inductees from Central Asia, the Baltic states, and western Ukraine into non-combat units, such as construction units. The growth of religious fundamentalism, be it Christian or Muslim, and the loss of "safe" regions for assignments, creates another potentially divisive issue for Russia's military leadership.

Criminal Behavior. Criminal activity within the Russian military is a constant and growing problem. The evidence is that crime is on the rise, as exemplified by a 50 percent increase in thefts of ammunition and weapons.¹⁶ There are numerous reports of military equipment that is stolen from military units and resold on the black market. The leadership of the military is partly responsible for failing to exercise adequate supervision of the troops and monitoring military equipment, but much of the blame rests on the corruption of the Soviet system itself. Now that the state is gone, and the inflated requirements for defense are exposed, many officers feel free to take care of themselves without moral compunction. Officers who rise above the corruption — such as General Lebed — have engendered great personal loyalty among the troops.

Exodus of Skilled Officers. The combination of poor pay and declining morale in the Russian military is leading to an exodus of skilled officers. This departure has demographic advantages given that Russia needs to downsize its military. This does not, however, address the equally important problem of the quality of the remaining personnel. The allure of opportunities in the consumer economy is driving thousands out of the military.¹⁷

2. Civilian Control of the Military

One challenge for Russia during this period is to strengthen the role of the Russian military in democratic reform. An essential element of a democratic military is civilian control.

Return and Drawdown. On February 27, 1990, the departure of the first Soviet troop train from Czechoslovakia began the process of downsizing the Russian military. Logistical issues regarding the families of the military men were not considered. While tanks, infantry fighting vehicles, and other military

equipment were loaded on flat cars, care for the families of servicemen were overlooked. Officers and enlisted personnel were given new assignments, but no provisions for family quarters were made. Household goods were loaded into containers and sent to relatives and friends. No government storage facilities were provided, nor could families trust their goods to military storage, had it been available.¹⁸

Decline in Military Readiness. Just as the Russian government faces difficulties reducing unprofitable industries, it also is severely challenged to reduce the military while maintaining combat readiness. The decline in combat readiness is reaching legendary proportions, as exemplified by the failed intervention in Chechnya. The decline in readiness began as the budget for the military was reduced to reflect the collapse of the Russian economy. The readiness of virtually all sectors of the military has declined. In July 1993, a reporter from the *Kommersant Daily* reported that Russian armies returning from the former republics were incomplete and for the most part had lost their fighting capacity.¹⁹ Many ships remain in port, unable to go to sea; the number of cruises performed by ships of the Pacific Fleet is reduced by half; some units in the fleet's aviation force are only at five percent of their recommended number of personnel;²⁰ all of the military services are undermanned and have little money to spend; army units stay in garrison with few field exercises; air force pilots fly roughly 25 hours a year, compared to 200 hours a year for their Western counterparts.²¹

In contrast with most conventional units, the strategic missile forces apparently maintain high standards of readiness, in large measure because greater emphasis is placed on personnel who maintain nuclear missile systems. There are, however, reports that the shortage of qualified personnel and the lack of fuels and lubricants restricts mobile missile complexes more than other units — even if combat readiness training has not declined. Unanswered are questions regarding the loyalty and resistance to corruption of these personnel, especially in light of repeated revelations of nuclear theft and smuggling.²²

Politicization of Russian Military. The increasing politicization of the military, a potential risk to democratic reform, is an outgrowth of the many strains affecting the military. Military delegates to the Federal Assembly remain split along generational lines, as older officers deplore the medias anti-military criticism, while many younger officers support increased efforts to promote democratic reform. Some members of the military see active participation in the Federal Assembly and State Duma as the only way to preserve a voice for better living and working conditions within the military.²³

Senior political and military leaders continue to warn military officers to minimize their involvement in politics. For example, Defense Minister General Pavel Grachev, while recognizing that servicemen have the right to seek office, he openly rebuked officers who ran in the December 1993 elections.²⁴ Russian President Yeltsin's military aide Dmitriy Volkogonov, after noting that 25 servicemen had forwarded their candidacies to the Federal Assembly, argued that, "Servicemen should not run for the parliamentary elections. They are to mind their own business."²⁵

President Yeltsin has worked assiduously to capture the support of the military, while minimizing its political influence. In part, he recognizes that military representatives are likely to support legislation that seeks to improve the social conditions in the military, which will make it more difficult to exercise budgetary discipline. As long as there is no broad political support in Russia for active military participation in government, Russia minimizes the risks of politicizing the military.

It is encouraging that the Russian military did not respond to calls to side with anti-government forces in the 1991 or 1993 coup attempts. When President Yeltsin dissolved the parliament on September 17, 1993, both parliament and the president claimed control over the Russian government and thus control of the military. Throughout the struggle between Yeltsin and Khasbulatov in the fall of 1993, General Grachev declared that the army would not commit itself to any political party, but would support the constitution.²⁶ Even though the military eventually

supported President Yeltsin, Grachev argued that the use of force on October 4, 1993, prevented the outbreak of civil war in Russia.

Lost Prestige, Benefits, and Compensation. The Russian military still retains a degree of legitimacy to the extent it serves society's need for security.²⁷ In January of 1993, President Yeltsin attempted to ease the strain on military members (and shore up his own support) by sending 41 presidential amendments to the *Law On the Status of Servicemen* to the Supreme Soviet. The purpose of Yeltsin's amendments was to elevate the status of the serviceman who are on active duty and those who have retired. Despite this effort, reports surfaced in the summer of 1993 that Russian servicemen were not being paid. It was revealed that many were not paid in June, and more than 60 percent of Russia's servicemen were not paid in July. Deputy Defense Minister General Konstantine Kobets reported that the Ministry of Finance owed the Defense Ministry more than 1.5 trillion rubles, and that many military bases faced food, fuel, and other material shortages. It is not surprising that, amidst rising tensions, some soldiers were not willing to perform their duties. Nor have these stopgap measures by Yeltsin had any appreciable effect.

In addition, Russian military officers face an uncertain and difficult future in a changing constantly environment. Indicative of the problems of the Russian military, and a result of the traditional disregard for human talent, is the current fate of young officers within the military. They face shortages of personnel and equipment, are ordered to do tasks once relegated to enlisted personnel, and are forced to live in sub-standard housing by the tens of thousands.²⁸ Worse, they are being used to unload railroad cars, stand on guard duty, and serve as bodyguards, agricultural workers, and perform menial kitchen duties.²⁹ And it is common for officers to leave their military units to conduct agricultural harvests.³⁰

Housing. The problem of housing military personnel returned from Eastern Europe is complex and frustrating. Since 1991, 155,000 officers, warrant officers, and their families left Germany. In 1992, 20,000 more families followed.³¹ In September 1991, *Krasnaya Zvezda* reported that 185,400 military families were

without housing. The German government provided funds to subsidize the construction of military housing for families leaving Germany. Housing, however, was not built, in part because the military leaders of Russia, Ukraine, and Belarus could not agree how to divide the money. The construction of 36,000 units in Russia is now far behind schedule. In February 1993, Pavel Grachev stated that the housing shortage was the most pressing problem facing the army — the number of homeless officers and their families was 150,000 and was expected to rise by 1995 to 400,000.

Declining Social Status. Military careers, a source of pride and prestige in Russia, are no longer prestigious, revealed Russian public opinion polls taken shortly after the 1993 coup attempt.³² This change is surprising, given that officers were historically accorded great respect and deference in Russian society. This is no longer true, as the Russian military experiences both a loss of purpose and the loss of its place in society.

Crisis in Recruitment and Conscription. Given these conditions, it is not surprising that Russia's conscription system is in shambles. The breakup of the Soviet Union accelerated the disintegration of the mandatory draft system. While there were 16,000 Estonians serving in the Soviet Army in 1990, within the year 3,500 recruits refused to accept their call-up notices.³³ Dmitry Yazov, former Soviet Defense Minister and Marshal of the Soviet Union, reported that thousands of conscripts avoided military service in 1990.³⁴ There are reports that more than 30,000 men evaded the draft in 1992, and that draft evasion, which was a problem before the breakup of the Soviet Union, continues to worsen — reaching upward of 75 percent. In the July 1993 call up, fewer than 10,000 of an eligible population of 64,000 served. By 1993, the problems of recruitment and desertion reached crisis proportions. Those who receive draft notices, if financially able, bought their way out of service by paying for medical deferments, while those who could not afford bribes turned to desertion.

In this climate, Russia's forces operate at 50 to 80 percent of normal manning.³⁵ It is no exaggeration to say that Russia's recruitment system has collapsed. Russia certainly needed to downsize its military force, and the lack of recruits may be a hidden

blessing. While the underlying problems that caused the decline in recruitment still remain in the Russian military, this problem must be overcome before Russia can legitimately modernize its military.

Contract Recruitment. In an attempt to resolve some of the procedural problems with the current conscription system, Russia is replacing the current program with a new two-tier system which retains the current draft but gives recruits some flexibility. Once called up, the individual might elect, after 6 months of service, to serve the 18 months under the old conscript program or choose to sign a multi-year contract with the military. Another alternative allows recruits to serve their remaining 18 months in a civil-service program, such as working in a hospital or a farm. The contract program is open to military personnel who had already served and been released from active duty. Contract soldiers, in principle, are required to perform less menial labor and are placed in better positions within the military. The program could offer stability within the ranks by giving senior leaders a better trained and more highly-motivated enlisted people.

The contract program, which was introduced in early 1993, is an important reform step because it may cause the military to review its fundamental training of recruits. The Russian military believes that the contract soldier program will lead to less monitoring of recruits.³⁶ The first phase of recruitment in the Air Force drew 12,358 contract servicemen. More than a 100,000 soldiers were accepted into the Army contract program. The contract soldiers now call themselves "pros", but there already are questions as whether the title is accurate.

Debate over the contract enlistment is just beginning. When asked about the contract method, Aleksey Y. Tsarev, chairman of the Subcommittee for the Armed Forces of the Committee of the Supreme Soviet for Defense and Security, said, "By 1995 the strength of the armed forces should be over 1.5 million. There will be about 900,000 soldiers and sergeants, half of whom will be on contract and half conscripted." Tsarev went on to say that a considerable amount of the military remains in a conscripted contingent in Central Asia and the TransCaucasus. He stated that

it will be impossible to operate the military in the future on a conscripted basis.³⁷ But others in the military do not view the contract program as the final solution.³⁸ Commanders in the field criticize the program because, while the contract program has positive benefits, there is no quality control on the selection of who is allowed to make a contract. There are many “undesirable” soldiers being allowed to call themselves “a pro.”³⁹ For now, the contract program remains mired in debate.

C. Conclusion

The Russian military is so mired in problems — low morale, housing shortages, draft evasion and desertion, corruption, declining prestige of the military, media exposes about abuse of recruits, and so forth — that this is a prescription for a societal disaster. Nevertheless, reforming the military involves certain challenges for Russian society.

Russia's political leadership confronts the challenge of articulating a new military doctrine to govern the role of the military in Russian politics and society. Russia needs a doctrine to communicate how the military relates to the government and reestablish its legitimacy with the people. As the Russian military downsizes, it faces the challenge of realigning its thinking toward more regional roles and missions, thereby diminishing expectations that it has a global role. For now, the Russian military must make the transition from a global to a regional military power if its size and capabilities are to be consistent with Russia's resources.

In conclusion, it is essential for the United States to remain supportive of Russia's efforts to strengthen the role of the military in democratic reform. We believe, however, that the issue of reforming Russia's military — and hence altering the basic structure of power and authority in Russian politics — is so sensitive because the Russian military represents the very security of the nation. Thus, unsolicited advice from the United States constitutes an unwarranted intrusion into the Russian military and the security of the state.

Notes

1. See Christopher Donnelly, "Evolutionary Problems in the Former Soviet Armed Forces," *Survival*, Autumn 1992, pp. 28–42, for background on the disintegration of the military.

2. See Brian D. Taylor, "Russian Civil-Military Relations After the October Uprising," *Survival*, Spring 1994, pp. 3–29.

3. See S. Frederick Starr, "Chechnya: The US Interest," *Wall Street Journal*, December 22, 1994, p. A14.

4. See Robert Bathurst and Michael Burger, *Controlling the Soviet Soldier: Some Eyewitness Accounts*, Center for Strategic Technology, Texas A&M University, 1981, p. 6.

5. The older soldiers will "trade" uniforms with the new younger soldiers, forcing the new soldiers to give them their newly issued boots, belts, and great coats. The object is to insure that the *stariki* leave the service with new clothing. The "old men" will insure that the heavy and menial jobs are performed by the new recruits. The *stariki* also insure that their supervisory roles place them in a position to receive better quality and more generous portions of food.

6. See "Died in the Army," *Nezavisimaya Gazeta*, November 15, 1993, p. 6, for reports that a Mothers Rights Foundation has been formed to seek information on the deaths of sons on active duty. Many cases are "under investigation" and rarely do parents find out the true cause of the soldier's death.

7. See Ellen Jones, *Red Army and Society: A Sociology of the Soviet Military*, Boston: Allen & Unwin, 1985, p. 139.

8. See Bathurst and Burger, p. 6.

9. *Ibid.*, p. 16.

10. See Jones, *Red Army And Society*, pp. 19–20, for a description of the varying ethnic backgrounds, regions, and education levels of the soldier in the Russian military. Individual conscripts were evaluated and selected by conscription committees within the conscripted soldier's locale. These committees, under the direction of the military district, are given specific quotas to meet using academic and physical requirements supplied by the military. The committee then selects and places the new recruit to a specific service and branch of the military. The conscript or recruit spends the first six months in a basic training environment. Also see Bathurst and Burger, *Controlling the Soviet Soldier*, p. 3. The basic fact of a soldier's life is that the enlisted men belong to informal groups of different types established in some cases against their will, and in some cases as a direct result of actions of the commanding officers. Most commonly, such groups are established along ethnic lines: Lithuanians are kept with Lithuanians, Georgians with Georgians, Uzbeks with Uzbeks, and so forth.

11. *Ibid.* Soldiers from Central Asia were considered more obedient and less political in their views. Conscripts of Ukrainian descent and conscripts from the Baltic States were considered more technically proficient and educated. Further, conscripts from the Baltic States were observed to exhibit greater negative attitudes toward the Soviet leadership. Since these were soldiers of the lowest level, they were inclined to show disdain for their NCOs and unit officers.

12. See Stephen Foye, "Rebuilding the Russian Military: Some Problems and Prospects," *RFE/RL Research Report*, Vol. 1, No. 44, November 6, 1992, p. 53.

13. Bathurst and Burger, p. 16. The soldiers from the city tend to have higher degrees than those from the rural areas. But others have roughly 8 years of rural secondary school (notorious for their poor quality), others completed 10 years of secondary schooling in a large industrial city, while others were conscripted for a year after graduation from institutions of higher learning.

14. See Michael L. Berbaum, *Social Factors in Soviet Military Performance*, University of Alabama, October 28, 1993, pp. 3–13. See also Bathurst and Burger, op. cit., p. 8, who found that the most NCO promotions went to ethnic Russians, while the least went to soldiers from Central Asia.

15. See W. Darryl Henderson, "Societal Effects on Soldier Commitment in the Vietnam, US, Soviet, and Israeli Armies," in Thomas C. Wyatt and Reuven Gal (eds.), *Legitimacy and Commitment in the Military*, New York: Greenwood Press, 1990, p. 169. "Baptisms are increasing and estimates are that approximately 30 to 50 million Russians are Orthodox Christians."

16. See Vladimir Gondusov, "Reportage on Increasing Crime Rate in the Soviet Army," *Moscow TASS*, March 29, 1990.

17. See Benjamin S. Lambeth, "Russia's Wounded Military," *Foreign Affairs*, March/April 1995, p. 92.

18. See Colonel P. Chernenko, "The Troop Withdrawal Has Begun," *Krasnaya Zvezda*, February 27, 1990, p. 3, for an example of the magnitude of the logistical problem of withdrawing such a large military force. In one day and in one unit, only 3 of 22 families of officers and warrant officers were able to secure apartments back in the Soviet Union. "Of more than 200 families, only 28 have apartments." The order had been given to create a boarding school for children whose fathers were to be sent to new locations. A facility to house the mothers would be located near the school. Other support facilities such as hospitals, commissaries, etc., would have to be built later.

19. See Mikhail Lashch, "Marshall Shaposhnikov Believes That Whatever Threat Exists for Russia Comes From Itself," *Kommersant-Daily*, July 17, 1993, p. 4, for the report that "Some 80 percent of stationary troop control posts have stayed outside Russia. Only one tank in four, one combat vehicle in nine, and one armored personnel carrier in twelve correspond to contemporary standards. The remaining combat equipment, according to the General, is only good for the scrap yard."

20. Senior Deputy Naval Commander Admiral Kasatonov, "Russia's Pacific Fleet," *Krasnaya Zvezda*, November 13, 1993, p. 1. Not so long ago the efforts of the Pacific Fleet focused exclusively on deterring the external enemy. Now these efforts are concentrated mainly on "extracting" financial and other means from the Center, leading to predictions that in two or three years up to 30 percent of the fuel and lubricant reservoirs of the Fleet will become unserviceable.

21. See Fred Hiatt, "Russia's Army: A Crumbling Giant," *Washington Post*, October 22, 1993, p. 1; see also, Lambeth, "Russia's Wounded Military," p. 89 for the figure that Russian Air Force pilots fly 25 hours per year, largely due to high fuel costs. By contrast, US Air Force pilots average 220 hours per year.

22. Colonel General Igor Sergeyev, "Life Goes On: Combat Training Is In Progress," *Krasnaya Zvezda*, June 11, 1993, p. 6, who when asked where the best results were found, said, "in units where young commanders have acceded to leadership. Ardent individuals who do not shun the dirty work."

23. "General Defends Political Role of Army," Statement by Major General V. M. Dudnik, *Moscow Russian Television*, October 17, 1993. Major General V. M. Dudnik, chairman of the public council of the "Army and Society" provided this position in October 1993: "The idea that the army, the Soviet Army, the Army of the Russian Federation, is outside politics is a false one to begin with. The army never was, cannot be, and never will be outside politics. This is the most powerful, most sharp, and most decisive argument in politics. The position being formulated now, that the army is the guarantor of stability and social order for the state, is a political one."

24. See "Says Officers Not To Run in Elections," *ITAR-TASS*, November 3, 1993.

25. "Navy Colonel Faces Dismissal for Political Activity," *Moskovskiye Novosti*, August 22, 1993, p. A3.

26. "Power Ministries Would Not Like To Interfere in Conflict," *Kommersant-Daily*, September 23, 1993, p. 3. "On Tuesday, (23 September 1993), Defense Minister Pavel Grachev held an emergency meeting of the ministry's collegium to discuss the Armed Force's stand in the event of a sharp deterioration of the situation in the country. The ministry's chiefs and military units' commanders flatly rejected the possibility of using the army for resolving domestic political problems. In particular, the commander of the Kantemirovskaya Tank Division, which took an active part in the events of August 1991, said that his soldiers would not enter Moscow under any circumstances. Units of the Tamanskaya Mechanized Infantry Division are currently involved in exercises in Nizhniy Novgorod Oblast. According to available information, on that same day Pavel Grachev had a telephone conversation with Boris Yeltsin, in which the minister advised the president of the military's viewpoint."

27. Vladimir Yermolin, "Why Are The Laws Designed To Protect Servicemen 'Working' Badly?" *Krasnaya Zvezda*, August 10, 1993, p. 3.

28. Oleg Bedula and Colonel Andrey Bonarenko, "Will Lieutenant Ivanov Become a General? That Depends Upon His Commanders," *Krasnaya Zvezda*, September 14, 1993 p. 2. Lt. Gen. Georgiy Ivanovich Shpak, chief of staff of the Volga Military District stated that the problems of the junior officers are, "apprehension, irritation, and uncertainty." Furthermore, "We polled young officers in a tank division which arrived in the Volga region from the ZGV [Western Group of Forces] on what their predominate feelings were. More than half of them answered apprehension, irritation, and uncertainty. As a result, every second one has requested a discharge. Later, when I met with these officers, I tried to find out just where was the cause of this hopelessness. Lack of faith that the social problems would soon be resolved, inability to change the situation.... But there is something else entirely different. The youth are terribly depressed by the ignorance of their superiors and by the fact that they are loaded down with totally irrelevant assignments. They all say with a single voice that they would simply like to have decent commanders."

29. "Young Military Deputies Criticize Defense Leadership," *Moscow Ogonek*, February 1990, p. 29. In one 1990 case, a Soviet Army major described an experience concerning a garrison commander, a lieutenant colonel, who "slapped the faces of two young lieutenants" as they stood in the position of attention. The lieutenants threatened that they would complain to higher authorities.

30. Author interview in Moscow, September 1994.

31. See Stephen Foye, "Russian Troops Return to Homelessness," *RFE/RL Research Report*, June 3, 1992, p. 61.

32. See "Armed Forces Prestige Low Among Servicemen, Public," *Izvestiya*, October 30, 1993, p. 15, for a poll conducted by Alesksey Levinson of the All-Russian Center for the Study of Public Opinion on Social and Economic Questions. Moreover, while the accuracy of Russian opinion polls concerning the status and prestige of the Russian military is questionable, the US Army report on Russian military morale noted that, "In July 1991, only 34 percent of Soviets reportedly had full confidence in the army."

33. Esther B. Fein, "Youths in Estonia Defying the Soviet Military Are Finding Eager Helpers," *New York Times*, April 5, 1990, p. A6. After Lithuania declared its independence, the treatment of Lithuanian soldiers immediately worsened. The government considered recalling all of its soldiers but recognized how provocative this recall might be. To cite Fein, "Published reports, court records and stories told by Estonian, Lithuanian, and Latvian conscripts say Soviet soldiers regularly beat, harassed, and terrorized young servicemen from the region." See also Esther B. Fein, "Soldiers Who Fear Their Own Men," *New York Times*, March 22, 1990, p. A6.

34. See "Yazov Reports Republic Anti-conscription Figures," *Moscow TASS*, December 5, 1990, for Yazov's report that, "The plan for the call-up has been frustrated in Georgia, Armenia, the Baltic republics and western oblasts of

Ukraine. More than 4,300 deserters who are concealed in all manner of ways by local bodies are being sought."

35. See "Defense Ministry Panel Discusses Current Issues," *Krasnaya Zvezda*, March 17, 1993, p. 1.

36. Major Vladimir Matryash, "How The 'Pros' Are Faring," *Krasnaya Zvezda*, July 2, 1993, p. 2.

37. See Interview with Aleksey Y. Tsarev, "Conscription Problems Discussed," *Moscow Ostankino Television*, September 14, 1993.

38. See "Interview with V. Dobrovolkiy: Military Council Official Views Personnel Problems," *Moscow Russian Television*, October 2, 1993, for a more negative view: "Contract voluntary service leaves no hope either — it is too burdensome for Russia at present. The service should either be mandatory for everybody or for nobody. Thus, if it is for everybody, there should be a law on compulsory military service. There should be certain exemptions for sons of single mothers, where mother and father are pensioners, and for only sons. The call-up should be at least 21, not 18, so that it is adults who come to serve in the Army. Also, the Army should create real human conditions for them."

39. See Matryash.

Chapter 11

Transformation of Ukraine's Military

by **Kenneth A. Cinal**

- A. The Problem
 - B. Managing Burdens From the Past
 - C. Recommendations for Action
-

A. The Problem

With the fall of the Soviet Union in December 1991 came the birth of Ukraine as a sovereign and independent state. Although the people of Ukraine voted to support a referendum for independence and political reform, the government and society face an intimidating array of challenges.

The fact is that Ukraine's geography, resources, population, and military force make it a critical determinant of political stability in Eastern and Central Europe. Foremost among the challenges of democratic reform is the arduous task of building a military that protects Ukraine's status as a democracy. This means that the military must be able to protect Ukraine from external aggression, and at the same time protect Ukraine's efforts to build a democratic tradition. The practical consequence is that Ukraine's military must, among other things, be guided by and responsive to Ukraine's civilian leadership, while maintaining its ability to respond to crises.

The transformation of Ukraine to a democratic state poses challenges to the government's ability to solve the myriad problems associated with independence. While Ukraine inherited many of the same problems as Russia, it has its own unique challenges to strengthening the role of the military in supporting democratic reform in Ukraine. Thus, in this chapter, we focus on the factors that influence the evolution of Ukraine's military in the

context of political and economic reform, examine the issues that are shaping Ukraine's military as an institution in a democratic state, and conclude with recommendations to assist Ukraine in its effort to transform the military to contribute to political stability.

B. Managing Burdens From the Past

By any standard, Ukraine is a large country — about the size of France — whose population of 52 million is dominated by deep and fervently-held nationalistic sentiments. As one official said, Ukraine's government must remedy, "The suffering and injustice Ukraine has suffered at the hands of its neighbors, especially being under the yoke of its northern neighbor for 350 years." A critical issue if Ukraine is to maintain its status as a newly-independent state is to establish a military under democratic, civilian control.¹

Russian Dominance. To begin with, the central problem in Ukraine's quest for independence is its lack of historical experience as a democratic state. Ukraine was the battlefield for many of the titanic struggles among the great powers of central Europe for the better part of this millennium. Given the refusal on the part of other states to recognize Ukraine's independence, Ukraine remained on the maps as part of the western rim of states that constituted the Russian empire during the last 300 years. And since the formation of the Soviet Union in 1917, Ukraine's military history was subsumed within the military of the Soviet Union. In all practical senses, Ukraine's military history and traditions were subordinated to the needs of the former Soviet Union. But when the Soviet Union dissolved in 1991 and Ukraine declared independence, Ukraine faced the immense challenge of building an independent military.²

Military Inheritance. In both relative and absolute terms, Ukraine was the beneficiary of a massive military inheritance from the Soviet Union. As the disintegration of the Soviet Union was formalized in late 1991, the vast parts of the arsenal of the former Soviet Union originally deployed in Ukraine were transferred de facto to Ukraine. As a result, Ukraine inherited the second largest conventional army in Europe and third largest nuclear arsenal in the world. In terms of size alone, Ukraine inherited an impressive

array of conventional forces, including an army with more than 700,000 personnel and an inventory that represented some of the former Soviet Union's most modern combat equipment.

The question often is asked why the Soviet Union left such large and, as it turns out, capable military forces outside the territory of Russia. For the explanation we must turn to Soviet military doctrine, in which Ukraine was considered to be the first line of defense. It was only natural for the Soviet military to deploy its most advanced equipment in Ukraine. More importantly, the Russian military always assumed and continue to believe that Ukraine is an integral part of Russia. The fact that the equipment remained in Ukraine through the disintegration of the Soviet Union attests to the unexpected nature and speed of events. It also is interesting to note that the word 'Ukraine' is derived from the Russian word for the edge, and as the southwestern edge of defense, the former Soviet Union assigned a disproportionately large share of weaponry to Ukraine.³

Force Structure. By default, Ukraine's military has become one of the largest and most formidable standing forces in Europe. It inherited approximately 700,000 troops from the former Soviet Union, and plans to decrease the military by the end of the 1990s.⁴ Ukraine's military possesses roughly 15,800 pieces of conventional armored vehicles — consisting of 6,400 tanks, 6,400 armored personnel carriers, and 3,000 artillery pieces. And Ukraine possesses 2,400 military aircraft.⁵ Ukraine also is the beneficiary of the most modern equipment that was in the Soviet inventory. Finally, Ukraine possesses approximately 1,800 strategic nuclear weapons, and repatriated tactical nuclear warheads to Russia in the winter and spring of 1992.⁶

Ukraine's Military Reorganization Plan. The Supreme Council of Ukraine directed the government to establish a ministry of defense and an armed forces. The ministry of defense started the military reorganization plan. A defensive strategy was adopted as Ukraine's security policy. The military doctrine to support this strategy stresses reasonable defense sufficiency. To support this doctrine forces need to be reduced, equipment must be maintained, and a modernization program put in place.

Ukraine's plan to drawdown the force envisions an interim force structure by the end of 1995, and a final force structure to be achieved by the end of 1999. This force needs to be large enough to meet Ukraine's security policy and be a force that Ukraine can afford to support. Although the plans are in place to transform the reorganized military by 1999, the military must deal with the reality of its problems today.⁷

There are, however, innumerable impediments to the reduction of Ukraine's military. Foremost among these is social upheaval that will be caused by forcing 300,000 or so military personnel into an economy that is gripped by inflation, unemployment, and economic stagnation. There is no social safety net to protect these personnel from the social and economic consequences of a society in the midst of democratic reform. Therefore, Ukraine has opted to move more deliberately as it restructures its military for the twenty-first century. In short, it is better to retain those people under at least a modicum of discipline in the military than to become malcontents in an economy that cannot provide adequate jobs and security.

Personnel Problems. While Ukraine's new independence promised to reform the management of personnel in the military, changes did not keep pace with expectations. Perhaps the most critical problem facing the reform of Ukraine's military is to destroy the traditions of abuse that afflicted the Soviet military. A senior defense official argued that Ukraine must eliminate those abusive practices if it is to have a modern military force.⁸ The greatest concern is the well-established tendency in the Soviet military to haze new recruits and subject units to abuse and maltreatment. Ukraine faces a glaring problem in this regard, as exemplified by the deaths of 209 recruits in the first nine months of 1993 — which the military cites as training accidents.⁹ The underlying reality is that Ukrainian military officials conceal the details of these deaths, thus leading observers to suspect that abuses may be common. The Ukrainians are suffering from the same problems that afflict the Russian military, as examined in the previous chapter.

Ukraine has no choice but to reform the military system. In an era in which the ranks of the military forces of Western states are filled with volunteers, Ukraine cannot allow abuses to destroy the willingness of its people to join the military. To remedy this problem, in March 1992 the Rada — Ukraine's Parliament — adopted the law on general military obligation and military service, which requires all Ukrainians to serve in the military. Thus, Ukraine uses a non-voluntary military service obligation of 12 months for university graduates and 18 months for the rest.¹⁰ But Ukraine's leadership is discovering that abuses in the military have immediate and tangible social consequences. With the incidence of hazing so pronounced, there are reports that up to 60 percent of those who are called to military service try to avoid the draft. It is common for the individuals who avoid the draft, as well as most deserters, to cite the widespread practice of hazing in the barracks as their reason.

Finally, the problem of hazing and abuse is even more worrisome when we consider that ethnic hazing is a profound source of unrest in Ukraine's military. The problem reflects the ethnic differences in the populations of eastern and western Ukraine. It is common, given the strong ties with Russia in the eastern parts of Ukraine, to find that military recruits from the western areas of Ukraine are beaten and harassed by those from the East. Conversely, the same is true in western Ukraine, where those from the east are beaten and harassed for their ties to Russia.¹¹ One of the positive signs of reform in Ukraine is that military officials are quite aware that the old system of discipline does not strengthen Ukraine's ability to sustain political and economic reform in the society at large or in the military. And while many in the military believe that these problems can be solved with time, this does not assuage those in Ukrainian society who stress that Ukraine needs to solve these problems sooner rather than later.

Education and Training. Under the Soviet system of training and education, schools were spread throughout many of the republics. With the dissolution of the former Soviet Union, each republic found itself with small parts of the larger educational

system. As with the other republics, Ukraine is now forced to create an educational system from scratch that comprehensively covers all relevant aspects of military training and education. In the meantime, Ukraine faces clear gaps in its ability to develop a fully integrated military structure dedicated to a democratic Ukraine. This condition has obvious consequences for the reliability, readiness, and modernization of a military force that is representative of Ukraine's government and society.

Criminal Activity. There is no doubt that pervasive economic disintegration in Ukraine is creating hardship for all segments of society, including the military. It is instructive to note that Ukraine is being affected by wrenching economic pain, as exemplified by the fact that between December 1991 and March 1993, food costs in Ukraine rose more than 4,300 times. But by contrast, military officers were forced to take a 14 percent cut in pay in the last year. As a result of economic chaos, dwindling pay, and the failure to enforce military regulations, Ukraine is witnessing explosive growth in criminal activities within the military. To put matters more directly, some soldiers in Ukraine's military are selling military hardware as a way to cope with Ukraine's current bout of inflation.

Criminal activity is such a pervasive problem in the military that private companies reportedly are able to purchase military installations. One routinely finds that all manner of military property — including fuel, uniforms, food, weapons, and parts — are being sold on the black market by soldiers seeking to supplement their salaries. As a result of illegal sales of fuel, shortages of fuel are common in Ukrainian military units. There are reports that a one-year supply of fuel is missing from the Black Sea Fleet, and that the Western Air-Defense Command illegally sold 150 tons of fuel. In view of reports that some general officers may participate in criminal activities, there are concerns that the problem reaches into the senior leadership of Ukraine's military.

The unavoidable conclusion is that Ukraine's governmental leadership is deeply concerned about the influence of criminal activity on the military.¹² The danger is that if Ukraine fails to address these problems, it may weaken the morale of the military

and undermine the confidence of the Ukrainian people in the legitimacy of their military.

Political Dissension in Military. Military dissent in Ukraine derives from various political and para-military groups that fall outside the military as well as fledgling associations within the military. For example, cells of the traditional Zaporozhian Cossack movement presently exist in the southern regions of Ukraine, Ukrainian Cossacks are active in the West, and Don Cossacks make their presence known in the East.¹³ Each movement, which has a long and proud tradition extending back into medieval times, was founded to promote patriotism and adherence to "Ukrainian values." Perhaps more disturbing are clear indications of the reemergence of the Ukrainian Army of Self-Defense, an organization reminiscent of the nationalistic movements of World War II. Proclaiming to possess a nucleus of 8,000 trained followers, this movement sees both "the American imperialist and the Russian chauvinist" as their main enemies, and claims to have sent troops into battle against the latter in the recent Caucasus conflicts.¹⁴

Within the Ukrainian military the main institution of potential dissent remains the Ukrainian Officers Organization, which was founded immediately after the failed August 1991 coup against then Soviet President Gorbachev. The Union has declared itself staunchly anti-Communist, and seeks to build a more nationalist Ukrainian army principally by diminishing the number of non-Ukrainians in uniform. Curiously, this organization has less influence among the Ukrainian officer corps than it does within the Ukrainian Ministry of Defense. This anomaly in political support makes it more difficult to calculate the ability of this organization to promote its nationalist program.¹⁵ The risk is that these political groups have the ability to erode the fabric of Ukraine's military structure and weaken the ability of the government to maintain civilian control over Ukraine's military.¹⁶

Crimean Frictions. The general political discontent in Ukraine with the situation in the Crimea continues to pose serious concerns for the military. Given the predominance of Russian heritage among the Crimean people, the vote in The Crimea in

favor of independence from Ukraine,¹⁷ and the fact that Crimea's parliament voted to change its official language to Russian and to make Crimea a sovereign entity, we have clear symptoms of a political and ethnic rift in Ukrainian society. This condition has immediate consequences for the ability of the military to support democratic reform in Ukraine.

Specifically, these actions by the Crimean Parliament have several negative consequences for Ukraine's military. The first is demographic. Because the individuals serving in the army in the western regions are predominantly of Ukrainian lineage, while the army in the east is of largely Russian ancestry, the division of Ukraine's military along ethnic lines is a main reason for political unrest in the military. Consequently, these ethnic divisions cause unrest and strife in the military, which often surfaces in the form of beatings and abuse of ethnic groups within military units. To complicate matters, the Crimean Parliament declared that only those of Crimean descent in the Ukrainian Army will be allowed to serve in the Crimea, thus deepening already-worrisome ethnic divisions in the military. The even broader concern is that a potential conflict between Kiev and the Crimea has far-reaching dangers, including not only the risk of civil war in Ukraine but also the involvement of western powers if Russia comes to the aid of the Crimea.¹⁸

Allegiance. When Ukraine nationalized the 700,000 former Soviet troops within its borders, the government insisted that the military officers and enlisted personnel who wished to remain in Ukraine's military forces take an oath of allegiance to Ukraine. In fact, nearly 500,000 former members of the Soviet military pledged their allegiance to the Ukrainian military. The decision by many Russian officers to stay was driven by family concerns, job security, and life style. The officers of the strategic rocket forces did not switch allegiance to Ukraine given the inherently sensitive nature of nuclear forces.¹⁹ And for the approximately 100,000 Ukrainian soldiers who are slowly returning from other parts of the former Soviet Union, the view in Ukraine is that their loyalty to Ukraine remains uncertain. Officials in the Ukrainian government have

admitted that they erred in not welcoming back all Ukrainians at the time Ukraine gained independence.²⁰

Solving Personnel Problems. Ukraine's political and military leadership is trying to reform the military personnel system. The thrust of reform is to increase special purpose pay, eliminate pay restrictions on pensions, increase insurance, and establish new pay rates for NCOs serving in officer billets. There also are efforts to establish programs to ensure that members of the military are offered social protection from hazing and harassment. The problem with reforms is the financial obligation assumed by the government, which clearly does not have the money to pay for the current program. The danger is that the establishment of new programs, which will be interpreted by the military as a pledge by the government, will transform itself into another point of frustration in Ukraine's military.²¹

Tactical Nuclear Weapons. With the dissolution of the Soviet Union, Ukraine agreed to transfer its nuclear weapons to Russia. The first step was to repatriate its tactical nuclear weapons to Russian control. While this process began in the winter of 1992, Ukraine stopped transferring the tactical weapons in March 1992 over the issue of controlling the dismantling process. At the time, the United States put pressure on Kiev to continue the transfer of weapons or risk the cessation of American economic assistance. Ukraine restarted the transfer process until all tactical nuclear weapons were removed to Russia. This decision remains contentious. Many officials in Ukraine believed that it was a mistake to give up tactical nuclear weapons because it was a primary bargaining chip in their relations with Russia and the West.²²

Strategic Nuclear Weapons. The disposition and control of the 1,800 strategic nuclear warheads in Ukraine still remain a source of tension between Moscow and Kiev. The issue is a complex one, involving Russian control over launch codes for the missiles amidst Ukrainian efforts to establish effective operational control. Meanwhile, political factions in the Rada want to use the weapons as a bargaining chip for more economic aid from Russia and the United States as well as security guarantees. In January 1994,

Ukraine signed a trilateral agreement with Russia and the United States to transfer the strategic nuclear warheads to Russia, and in November 1994 Ukraine signed the Non-Proliferation Treaty. This agreement commits Ukraine to relinquish its nuclear weapons over several years in exchange for increased economic aid from both the United States and Russia.

Black Sea Fleet. Yet another source of tension between Moscow and Kiev is the rightful ownership of the Black Sea Fleet. The Massandra Agreement gave control of the fleet's 300 vessels to Russia, and in turn Russia reduced Ukraine's extensive energy debts, but Ukraine's Parliament rejected this agreement. Both governments now have agreed to a fifty-fifty split of the fleet. Because Ukraine seeks a Navy but does not have a need for half of the fleet, it will try to use this as a bargaining chip for economic aid or will offer to sell part of the fleet to the highest bidder. An unresolved issue continues to be the basing of the Russian half of the Black Sea Fleet. Russia wants Sevastopol and five other Crimean ports, but Ukraine only wants to rent them Sevastopol for \$2 billion a year. Ukraine wants Russia to buy or trade energy for part of the fleet and base leasing rights.²³ The fleet is reported in gross disrepair with its newest ship being 15 years old. Ukraine is fighting for the fleet as a matter of principle and more importantly, for its potential economic leverage.

C. Recommendations for Action

OBJECTIVE: Establish Democratic Military in Ukraine. The foremost objective for Ukraine is to build a military that is imbued with the tradition of civilian control in a democratic society. There are several steps that Ukraine must take to accomplish this.

Recommendation 1: Establish Civilian Control of Military. It is important to promote Department of Defense exchange programs in order establish civilian control of the military. The DOD might exchange staffers to provide assistance and examples of how civilians relate to the central function of

military command and control. These exchanges can be organized to maintain a relatively low profile with minimal expenditures.

Recommendation 2: Build a new Ukrainian Military Culture. Ukraine must establish a new culture, tradition, and sense of discipline in the military. These areas can be developed through training and leadership. The United States can assist the military in developing programs to establish this culture. A military to military exchange for training and exercises has several advantages, and can be conducted discreetly.

Notes

1. Author interviews in Kiev, September 1994.
2. "A Survey of Ukraine, Unruly Child," *The Economist*, May 7, 1994.
3. *Ibid.*
4. See "Ukraine: Fact Sheet," *US Department of State*, October 18, 1993, p. 3.
5. The case with helicopters is quite different, given that Ukraine has 285 helicopters to Russia's 1,200. See "Spoils of Peace," *The Economist*, March 21, 1992, p. 53.
6. *Ibid.* The numbers used for these comparisons and throughout this paragraph reflect the data in this article.
7. Stephen D. Olynyk, "Emerging Post-Soviet Armies: The Case of the Ukraine," *Military Review*, March 1994.
8. Author interview in Kiev, Ukraine, September 1994.
9. Oleg Strekal, "No Way to Run an Army," *The Bulletin of the Atomic Scientists*, January/February 1994.
10. See Olynyk.
11. See Strekal.
12. *Ibid.*
13. See Valeriy Izmalkov, "Ukraine and Her Armed Forces: The Conditions and Process for Their Creation, Character, Structure and Military Doctrine," *European Security*, Vol. 2, No. 2, Summer 1993, pp. 312-14.
14. "Feind in Flammen," *Der Spiegel*, August 22, 1994, p. 126.
15. See Izmalkov, p. 315; Bohdan Pyskir, "The Silent Coup: The Building of Ukraine's Military," *European Security*, Vol. 2, No. 1, Spring 1993, p. 143. In

discussions with a senior Ukrainian military official, the argument was made that the purpose of the Cossack forces was to educate, study, and develop the patriotic views of the people. The implicit inference is that the Cossacks have to be ready to defend their interests which do not necessarily parallel those of the Ukrainian government. Author interview in Kiev, Ukraine, September 1994.

16. Author interview in Kiev, September 1994.

17. The vote in favor of independence was 54 percent, and in some areas support for independence ran as high as 85 percent.

18. "A Survey of Ukraine, Unruly Child."

19. "Spoils of Peace."

20. The explanation for the failure to welcome returning soldiers was the judgment in the government that Ukraine did not have the financial resources to support the expected number of returning soldiers and their families. Author interview in Kiev, September 1994.

21. Strekal.

22. With the tactical weapons, defense officials believe that Ukraine would not be isolated from other countries and thus would be accorded some of the respect it deserves.

23. "A Survey of Ukraine, Unruly Child."

Chapter 12

Managing the Evolution of Russia's Military

by Mark D. Shackelford

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- A. The Problem
 - B. Sources of Danger and Friction
 - C. Recommendations for Action
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A. The Problem

The focus of military policy during the Soviet era was the desire to support the spread of Communism and to increase the alignment of nation-states under the Soviet umbrella. Russia's military, rocked by the impact of a changing economy, found itself without a major threat. Force reductions and budget cuts left the military in a new era of social problems and a sudden shift from abundance to destitution. Attempts by Russia to influence the former Soviet states, now the Commonwealth of Independent States (CIS), were met with mild enthusiasm in some cases and outright rejection in others. Russia, in effect, lost the ability to influence these states, some of which were composed of large ethnic minorities.

Not surprisingly, the Russian military is developing a new doctrine to shape its role in international relations as an emerging democratic society. Russia's new doctrine reflects several factors, including a diminished role of the Russian military in policy; lessons learned from the Persian Gulf War; growing technological advancement of military weaponry; rising nationalism in CIS states and subsequent loss of Russian influence; difficulties in retrieving nuclear weapons from the CIS states, and in some cases the emergence of a trade in nuclear materials; and sensitivity to

anti-Russian activities affecting the 25 million ethnic Russians living in the CIS states.¹

This chapter explores the implications of the new doctrine for relations between Russia and other CIS states in the "near abroad." It addresses the role of the new military doctrine in Russian foreign policy in the near abroad, examines the potential for uncontrolled proliferation of nuclear weapons, with particular reference to political events in Ukraine, considers potential problems with the Conventional Forces in Europe Treaty as it applies to Russia and the near abroad, and finally concludes with recommendations for US policy to strengthen international peace and stability in Eurasia.

B. Sources of Danger and Friction

The new doctrine focuses on issues that are central to Russia's view of national security in the post-Soviet environment. Key areas of interest include regional stability in light of the military's attempts to gain permanent influence in the near abroad through peacekeeping intervention, the proliferation of nuclear weapons to other CIS nations, and Russian perceptions that the West is taking advantage of the successor states in enforcing the Conventional Forces Treaty. These areas are of growing importance to the United States given their influence on the balance of power in Eurasia.

1. Russian Influence in Near Abroad: Troublesome Patterns

The demise of the Soviet Union left the Russian military in the untenable position of facing unclear threats in the midst of economic collapse and concurrent cuts in fiscal and political support. The loss of the Warsaw Pact and the potential loss of influence in the successor states left Russia without buffer zones against foreign aggression. As a consequence, Russian military leaders have exercised an uncharacteristic degree of assertiveness not observed in recent years. While Russia slowly makes the transition to a democratic society, the military is forced to manage the problems of troop relocations, force downsizing, and ethnic

Russians living on non-Russian soil. With this turn of events, the military has begun to assert itself in foreign policy in order to counterbalance the unwillingness of the Russian government to participate. The near abroad has been the subject of increasing Russian interest.²

There are two reasons for this assertiveness. First, the dissolution of the Soviet Union had an enormous impact upon the Russian people. Once accustomed to status as a major world superpower, they found themselves accorded the influence of a third-world state. Aggressive activity in the foreign policy regime was necessary to psychologically bolster domestic support by enhancing Russia's national identification.³ Second, Russia maintains geopolitical, economic, and ethnic interests in the near abroad. In geopolitical terms, Russia's near-global span of influence ranges from the Pacific Ocean on the East to Europe on the West, from the Arctic Ocean on the North to the Black Sea and the Turkey-Iran-China border on the South. Economically, Russia realizes that the successor states possess many natural resources, and that there is always the possibility of economic reintegration into Russia. Finally, Russians argue that they have a sense of responsibility for the estimated 25 million ethnic Russians who live in these states under potentially hostile circumstances.⁴

Efforts at Military Reunification. The military's first efforts to deal with these challenges were apparent when they attempted to militarily unite all of the CIS nations under a single unified command structure. Rationalizing that the individual states lacked a common strategic threat, Russia hoped to regain some of the influence from the previous Soviet era. Much to Russia's dismay, however, an organizational division between the CIS command and the government in Moscow never gained political support in the CIS member states. As the successor states perceived correctly that the CIS command served the interests of Moscow rather than those of the collective group, the opportunity for a unified military structure slipped away.⁵

The next effort came in the form of "joint" forces, predominantly between Russia and the Central Asian states, whose purpose was to provide a peacekeeping role in the near abroad. While they were

employed to some extent in Georgia, Armenia, and Tajikistan, the force essentially consisted of Russian soldiers.⁶ This change of focus to local conflict and the increased burden of providing forces fell to the Russian military, and this eventually led the Russian military to a doctrinal reorganization.

Elements of New Russian Military Doctrine. The Russian military responded with a doctrine that organized the army around three components. First, a limited number of combat-ready troops are to be stationed in forward locations to repel aggression. Second, rapid reaction reserve forces are to be held back in the event of aggression on a larger scale. Third, strategic reserves are to be formed in response to the threat or in anticipation of large-scale operations. Given Russia's limited resources and vast borders to protect, Russia opted to station these forces in central locations from which they could be rapidly deployed to conflict areas. The actual border areas were secured initially by border guards, which were indigenous yet highly armed and experienced forces. Seasoned Russian soldiers will be added only as necessary.⁷

The actual role of these Russian soldiers was deliberately vague, argued members of the CIS. Their peacetime role was described as suppressing, "possible provocations and encroachments on the security of [Russian] citizens, the sovereignty, territorial integrity, and other vitally important interests of the Russian Federation."⁸ In January 1994, Russian Foreign Minister Andrei Kozyrev indicated his strong support for maintaining a presence in, "regions which have been in the sphere of Russian interests for centuries" and avoiding the emergence of a "security vacuum" in the near abroad.⁹ The following April, President Boris Yeltsin decreed that the military negotiate the right to maintain up to 30 military bases outside of Russia.¹⁰ The Russians, it seems, were ready to apply leverage to perpetuate their influence for the foreseeable future.

Peacekeeping or Peacemaking? Russia's Role in the South. Along Russia's southern border with the near abroad, Russia worries about the influence of Islamic extremists, particularly from Iran, on political stability and security in the region. With a large Islamic population, these border areas are

particularly susceptible to turmoil.¹¹ Based on concerns about security in these troublesome areas of the near-abroad, the Russian military sought to promote stability within the sovereign territory of these states. But Russia's manner of intervention is cause for grave concern for these states.

The ground rules for peacekeeping in the CIS were established in the March 1992 Kiev Agreement on Collective Security Forces and the July 1992 Tashkent Protocol on Collective Peacekeeping Forces.¹² These agreements stipulated that any tasking of peacekeeping forces must be based on a request by all conflicting sides, and that a ceasefire is agreed upon before troops are dispatched. Further, the peacekeeping force must be formed from states which were not party to the conflict. The growing sense among regional observers is that Russia intends to use the CIS agreements as a cloak of respectability to cover the defense of Russian interests. This extends to an apparent Russian objective to keep the peacekeeping role in the near abroad within the purview of the CIS, which Russia dominates, rather than allowing other alliances, such as NATO, to become involved.

When Russia articulated this peacekeeping role, its military doctrine lacked any definitive guidance for conducting such missions. Perhaps the best example of Russian military thinking on this subject comes from the words of Major General Ivan Vorob'yev.¹³ The doctrine that he proposed transforms "peacekeeping" into "peacemaking," which involves fighting local wars and counter-insurgency operations.¹⁴ Further, it contravenes the standards of peacekeeping established by the United Nations, which advocate impartiality, consent, minimum use of force, and UN control.

Intervention in Georgia. Perhaps the most revealing case of Russia's interpretation of peacekeeping was in Georgia following the overthrow of the Georgian leader in December 1991. Initially, Russia supported the government with the transfer of military equipment, but when extensive fighting broke out in the separatist Abkhazian region, the Russian Ministry of Foreign Affairs pursued a mediating role and brokered a ceasefire. There were allegations, however, that the Russian Ministry of Defence

assisted the separatists with arms, training, and even direct combat.¹⁵ The ceasefire was implemented in August 1993.

When the ceasefire was broken the following month, Russia refused to assist the government. Defence Minister Pavel Grachev even went so far as to criticize the Georgian leadership for triggering the civil war and demanded the withdrawal of Georgian troops from Abkhazia. When the troops left, the rebels claimed the region and the Georgian government gave up the fight. Georgia acceded to Russian demands to join the CIS and the Tashkent Collective Security Treaty. Suspiciously, rebel fighting ended almost overnight. Russia subsequently provided arms and equipment to the Georgian government and, more significantly, brokered a deal to deploy peacekeeping troops permanently in the region. Peacekeeping in Georgia reflected Russian support for rebel units and pressure on the government to accede to permanent basing of Russian troops on foreign sovereign soil. The motive in this case probably involved the Russian minority and Russia's desire to maintain access to the Black Sea. Close ties to this region directly strengthen Russia's quest for geopolitical strength.

Exploiting Instability in Azerbaijan. In Azerbaijan, instability erupted with the overthrow of a pro-Turkish regime in favor of a former Communist leader. Russia clearly seeks greater security along this border region with Turkey, which is rich in oil and gas. Again, the Russian military seemed to go beyond its assigned role, as Defence Minister Grachev played a substantial role in negotiating ceasefires and engaging in diplomatic activity — often at the expense of the Ministry of Foreign Affairs.

Defensive Intervention in Tajikistan. In the Central Asian region bordering on Afghanistan, Russia's peacekeeping role operated differently. In Tajikistan, Russia followed a dual policy of creating indigenous military forces with close ties to Russian forces while relying on forward deployed Russian border troops and military units. While Russia played an ambiguous role in civil strife there, Moscow contributed significantly to the building of the Tajik military and provided the primary source of military and economic support for the government. Russia's involvement resulted in closer ties, as exemplified by the fact that some Russian

officers transferred to the Tajik military and some local residents joined the Russian unit in the region. This blurring of the lines between Russian and Tajik forces ultimately enhances Russia's ability to permanently base forces there. The only limit to Russian involvement in Tajikistan appears to be a lack of popular support at home out of fear that it will produce another Afghanistan.

Welcomed Involvement. Not all cases of Russian intervention in Central Asia are seen as unwelcome meddling. In Armenia, Russian forces are seen as a guarantee against Turkish intervention by pro-Turkish rebel factions in the civil war. In Kazakhstan, the governing regime maintains close ties with Russia and has proposed the formation of a "Eurasian Union." They have stopped short, however, of granting dual citizenship to Russians, a ploy that Russia hoped would strengthen ties and enhance the legitimacy of Russia's presence in the near abroad.

Outright Meddling in Moldova. In Moldova, however, Russian military interference is a case of outright meddling. When a rebellion emerged from the largely ethnic Russian Trans-Dniestr region, Russia's 14th Army commanded by Major-General Aleksandr Lebed openly supported the rebel faction. While the ostensible purpose was to protect the rights of the Russian people there, the more plausible Russian objective was to prevent Moldova's integration into Romania. With the passage of time, increasing numbers of 14th Army officers identify with the region and more local residents join their ranks. The result is similar to that in Tajikistan, in which Russian military units with close ties to a sovereign region outside of Russia proper increase the potential for the permanent basing of Russian soldiers in the near abroad. The benefit for Russia is the ability to build influence in another border region if part of Moldova seeks integration with Romania.

The Baltic States: Coercion and Concession. Russia's interests in the Baltic States relate to access to Kaliningrad and the Baltic Sea and concerns about ethnic Russians living in the region.¹⁶ The withdrawal of Russian troops from the area weakens Russia's buffer with the West and heightens latent Russian fears about Germany. When the Baltic States explored the possibility of

joining NATO, Russia's political opposition expressed vehement dissent.¹⁷ The states backed down and were subsequently offered participation in the Partnership for Peace which provides military exchanges without extending the security guarantees that are part of NATO membership. With the Russian minority in the region, Russia continues to have an interest in the Baltic States, but Russia's influence will involve economic leverage rather than military presence.¹⁸

Ukraine's Distrust of Russia. Ukraine proves to be the most reluctant to allow herself to become intertwined with Russian security interests. The issues are fourfold: denuclearization and Kiev's reluctance to follow through with nuclear weapons dismantlement; division of the Soviet Black Sea Fleet and its basing at Sevastopol; status of the Russian ethnic minorities in eastern and southern Ukraine; and Russia's economic and energy debt interests in Ukraine.

Nuclear Weapons. The nuclear weapons issue, addressed later in the chapter, appears to be on its way to resolution. Russia was justifiably uncomfortable with the loss of a significant portion of its nuclear arsenal. When Russian efforts to enlist Ukraine into a unified military structure fell on deaf ears, the Russians took advantage of US assistance to compel Ukraine to relinquish its nuclear weapons. While this strategy gave the United States an active role in Russia's near abroad, the more important effect is to legitimize Russian pressure on the near abroad. The outcome, while a success from Russia's perspective of regaining control of the weapons, places Ukraine in a position of influence with the West that few other CIS nations possess, and this undoubtedly creates discomfort for Russia.

The Black Sea Fleet and Crimea. The status of the Black Sea Fleet represents a modest victory for Russia. With an agreement to split the fleet with Ukraine, Russia retained a portion of the hardware and personnel.¹⁹ After a great deal of squabbling, Ukraine finally conceded to Russia's desire to retain the fleet base at Sevastopol in the Crimea.²⁰ The danger comes from unrest in Crimea and its potential for self-proclaimed independence. The area, as well as the volatile Donbass region of eastern Ukraine, is

predominately Russian in ethnic background and most likely will align with Russia if secessionist forces in Ukraine were to prevail. And this outcome would increase Russian influence in the region at the expense of Ukraine's sovereignty.

Economic Ties. Russia's economic ties to Ukraine involve both Ukraine's industrial capacity and large energy debts to Russia. With Ukraine's independence, Russia lost its primary sources for manufacturing ballistic missiles, building ships along the Black Sea, and designing Antonov aircraft.²¹ Russia must continue to cultivate access to these capabilities to preserve its economic security. Ukraine also relies on Russia for nearly 100 percent of its energy needs.²² Due to Ukraine's poor financial situation, some authorities see Russia's energy aid to Ukraine as a gift with little hope of repayment.

2. Invasion of Chechnya

Background. When the Soviet Union broke up in 1991, Chechnya was the only autonomous region of the Russian Federation²³ that insisted on total independence.²⁴ This came on the tail of a 100 year effort to assert its freedom from Moscow. Independence was not achieved, largely due to Chechnya's oil reserves and its geopolitical position adjacent to Georgia, where Russia has fought since 1991 to establish a permanent military presence. Further, Chechnya had become the home of some of Russia's most successful organized crime gangs — a constant source of irritation in Russia's evolving free-market economy. The threat posed by Chechnya's secession clearly presented an unacceptable risk to Russia's unity and to the struggling government of President Boris Yeltsin. In late 1994, Mr. Yeltsin declared a state of emergency in the region. His announcement was quickly followed by an air assault in which the Russians initially denied involvement. The subsequent ground assault, by Russian troops, clearly communicated Russia's interests.

Military Intervention. Russia's intervention in Chechnya was not fully supported by the military. General Boris Gromov, an Afghanistan war hero, and General Aleksandr Lebed, whose 14th Army prevailed in Moldova, both opposed Yeltsin's initiative. Both

generals, incidentally, appear to have political aspirations. Fighting in Chechnya gained disfavor in public opinion as Russian soldiers died in what appeared to be an unwinnable war reminiscent of Afghanistan. This perspective only intensified when it became obvious that the Russian Army might capture territory in Chechnya, but not break the will of the rebel fighters. Indeed, Russian forces were embarrassed by their inability to win a quick victory.

Long-Term Consequences. It is clear now that military intervention in Chechnya will likely fail to achieve a peaceful solution, for a number of reasons.²⁵ Potential exists for a political settlement but only if Russia is willing to agree to something less than complete control over the region. With Russian military leaders, notably General Gromov, postured to sue for peace and lead the withdrawal, there is much political leverage to be gained at the expense of the Yeltsin government. From a military standpoint, the whole affair is likely to be reminiscent of failure in Afghanistan and contribute to the worsening of existing low morale and poor effectiveness images. It will certainly do little to inspire confidence in the Russian Army as a peacekeeping force.

3. Dangers of Uncontrolled Nuclear Proliferation

The issue of nuclear proliferation in the Soviet successor states creates an atmosphere of uncertainty and hostility. The consequence is to drive the Russian military to establish a doctrinal basis to support Russian interests in the former Soviet republics. While the situation is not sufficiently unstable to warrant military action, the uncertainties surrounding nuclear weapons leave Russia in a tenuous position. To understand why the nuclear weapons are critically important in the Russian view and hence in Russia's military doctrine, it is useful to examine recent events in the disposition of the former Soviet Union's nuclear arsenal.

Nuclear History. During the Soviet era, military doctrine stipulated the dispersal of certain nuclear weapons to various republics to maximize its capability against the United States. The majority of warheads, some 7,200, were deployed in Russia.

Ukraine and Kazakhstan followed with approximately 1,400 each. Belorussia, now Belarus, had 54.²⁶ With the disintegration of the Soviet Union, nuclear weapons remained in the hands of several successor states. This state of affairs presents challenges to both Russia and the United States. Russia retains legitimate security concerns in the bordering nations that possess nuclear weapons. The United States, concerned in a broad sense with nuclear disarmament and the implementation of the Strategic Arms Reduction Treaties (START I & II), recognized Russia as the sole "nuclear successor" state. Both states wanted to prevent nuclear proliferation and strengthen the 1968 Non-Proliferation Treaty (NPT).²⁷

Ukraine's Reluctance and Russian Pressure. On December 30, 1991, a further agreement was made at Minsk which gave Ukraine, Belarus, and Kazakhstan formal power to veto a Russian decision to launch nuclear missiles on their territory. Ukrainian nuclear weapons were placed under the CIS Joint Strategic Forces Command. All nuclear weapons outside of Russia were to be dismantled by the end of 1994.²⁸ This accord was followed on May 23, 1992 with the Lisbon Protocol which stipulated adherence to the NPT in, "the shortest time possible." It also required that START I had to be ratified at the same time as the Protocol. Ukraine President Kravchuk subsequently forwarded a letter to President Bush, which declared that Ukraine needed seven years to comply with dismantling nuclear weapons. He also argued that Ukraine has the right to control the non-use of the nuclear weapons on its territory.

There was an apparent rift between President Kravchuk's agreements and what Ukraine's Parliament — the Rada — was willing to ratify. Indeed, the Rada delayed ratification until over a year later. Even then, it placed conditions of security guarantees, compensation, and economic aid on Ukraine's willingness to implement START and the NPT.²⁹

Ukraine's reluctance to comply with the provisions of these treaties came in large part from concerns about Russia's long-term intentions. There was the threat of reunification or reabsorption of eastern or southern Ukraine, both largely ethnic Russian, into

Russia. The Russian Parliament had nullified the 1954 transaction which had transferred the Crimea to Ukraine. There was disagreement over the fate of the Black Sea Fleet and its base at Sevastopol. Russian politicians frequently made statements attacking Ukrainian independence. There was fear of military intervention as exemplified in Georgia, Armenia, Azerbaijan, and Tajikistan. Russia was applying economic pressure in the way of increased rates for oil and natural gas. Finally, there was a belief that the only US interest was in the nuclear weapons, not the plight of Ukraine as evidenced by the differing sizes of economic packages that Washington proffered on Russia and Ukraine. In fact, there was growing skepticism within Ukraine over American interests in Ukraine's future. Nationalistic leaders were openly wondering why the United States was interested in saving starving people in Africa but uninterested in offering similar aid or protection to Ukraine.³⁰

As a result of this Ukrainian discomfort, the Rada ratified START with a rejection of the "shortest possible time" stipulation of the Lisbon Protocol. Ukraine claimed ownership of the nuclear weapons on its territory, but pledged to eliminate them gradually.³¹ This was an obvious effort to stretch out the denuclearization process to enhance the weapons' utility for bargaining. Ukraine further placed limits on the accord requiring that other signatories guarantee never to use nuclear weapons against Ukraine, not to use or threaten to use conventional forces against Ukraine, and to refrain from economic pressure against Ukraine. Reductions were limited to the same percentages of weapons that START placed on Russia (36 percent of delivery vehicles and 42 percent of warheads); financial and technical assistance for dismantlement was required; nuclear components were to be returned to Ukraine for civil use; and finally, Ukraine required verification that the components were not being used to create new nuclear weapons.³²

Clearly this was an effort on the part of nationalistic forces in Ukraine to assert independence in international politics. While Ukraine had little capability to operate and maintain the nuclear weapons on her soil,³³ its leadership insisted that the world,

specifically the United States and Russia, take notice. Fearful that its independence from Russia was fragile, Ukraine opted to take maximum advantage of these assets in hopes of gaining a guarantee of security as well as greater economic assistance from the West.

Continuing pressure from the United States and Russia resulted in the Tripartite Nuclear Statement between those two parties and Ukraine, which was signed on January 14, 1994. Ukraine agreed to eliminate nuclear weapons in exchange for compensation, dismantlement aid, and security assurances. The Rada's adoption of the resolution three weeks later cleared the way for the implementation of START and lifted the conditions placed on the Lisbon Protocol.³⁴ Though some details — such as the exact formula for compensation and the strict timing of the dismantling action — remained to be resolved or publicized, the political hurdles appeared to be overcome.

On November 15, 1994, the last major hurdle in Ukraine's denuclearization apparently moved toward resolution when the Rada finally voted overwhelmingly to join the NPT and hence become a nuclear-free nation.³⁵ This move, made in exchange for apparent assurances from the United States, Russia, and Britain that Ukraine's border will be respected and that Russia will refrain from using nuclear weapons against Ukraine, opened the door for ratification of the NPT and START I.³⁶ The United States provided further assurance that it will consult with Kiev if Ukraine were ever threatened militarily.³⁷

While Ukraine's concession on nuclear ownership satisfies the interest of the United States in countering proliferation, there are two potentially significant impacts on regional stability. First, it leaves Ukraine less able to counter the effect of Russian doctrine through deterrence. As Russia seeks to solidify its influence in the near abroad, a non-nuclear Ukraine presents a much more lucrative opportunity for intervention in the event of internal ethnic violence. Second, Ukraine's concession provides a potentially destabilizing influence. If any party threatens Ukraine, it will have less leverage for protection and will have to rely on intervention by the United States or the United Nations.

4. Managing Stability Through the CFE Treaty

In the last several years, Russia's military doctrine shifted away from the large conventional and nuclear forces designed for global war. With the end of the cold war, the dissolution of the Warsaw Pact, the breakup of the Soviet Union, and the economic changes in Russia, the Russian military found itself without a protective buffer from Europe. The result was a severely reduced military and the loss of some of Russia's best forces to the successor states. Given these environmental changes as well as observations from the Persian Gulf War, Russian military leaders formulated a new doctrine around smaller, more flexible, rapidly mobile forces strategically stationed around the country. This approach led to a basing concept that challenges the terms of the Treaty on Conventional Armed Forces in Europe, commonly referred to as the CFE treaty.

The CFE treaty, which was signed in November 1990 prior to the demise of the Soviet Union, reinforces the process of democratic reform. The agreement between NATO and the Warsaw Pact nations was designed to reduce the possibility of conventional war by setting limits on the numbers of weapons in five areas: tanks, armored combat vehicles, artillery, combat aircraft, and attack helicopters.³⁸ These limits were allocated to groups of state parties wherein each group determined how to divide forces to be consistent with those limits. By the time the treaty went into force in July 1992, both the Warsaw Pact and the Soviet Union no longer existed. The limits applied by the treaty to the resulting geopolitical structure made little strategic sense, but largely due to inertia arms control experts and diplomats scrambled to preserve as much of the treaty as possible.

Troublesome Northern and Southern Areas. The treaty was designed to counter the threat of a classic Warsaw Pact attack through Germany by limiting offensive forces that could be brought to bear on Central Europe. Concentric rings of territory, emanating from Central Europe to the East, constrained the amount of military hardware in each region. Norway and Turkey, fearful that the weaponry removed from Central Europe could be moved North and South to the flanks, petitioned for and won

additional limits which were placed on the northern and southern portions of the Soviet Union. In spite of the fact that these were two widely separated regions, the treaty placed only one collective set of limits on these flanks. The resulting effect was extremely constraining on Russian hardware, and not surprisingly, the areas known in the treaty as the northern and southern Flanks became objects of concern for Russia.

On the northern Flank, the limits applied to Russia's Leningrad Military District. In the days of the Soviet Union, this region was vital to the defense of St. Petersburg and the Kola Peninsula. It formed a line of defense from the West behind the Baltic States. With the independence of the Baltic States, Russia lost their benefit as a security buffer. As the region made the transition to front-line defense, the military structure in the area became all the more important to Russia.

On the southern Flank, the limits applied to the old republics in the Soviet Union. They are now the independent states of Armenia, Azerbaijan, Georgia, Moldova, Russia, and Ukraine. Several of these newly independent states laid claim to the forces on their soil resulting in protests by Russia because the forces involved represented some of the best. Russia was fearful that the number of states involved further reduced its share of treaty-limited weaponry in the region.

In an effort to shift the limits to a more favorable proportion, Russia proposed a method of reallocating forces based upon the factors of area, population, and length of borders to be defended. The resulting distribution heavily favored Russia, giving it a larger share of tanks at the expense of the other countries, particularly Ukraine and Belarus. The resulting numbers, however, greatly exceeded the limits on such weapons allowed by the treaty — perhaps an indicator that Russia was in favor of changing or ignoring the limits. This proposal was ultimately disregarded in the implementation of the treaty.

In June 1994, Russia again approached the reallocation of weapons with respect to the sub-limits affecting Armenia, Georgia, and Azerbaijan. Russia proposed decreasing the numbers of tanks allotted to these states, with Russia retaining the difference for

use in the regions bordering these states.³⁹ While the disposition of these sub-limits does not require treaty renegotiation, this proposal might be indicative of Russia's desire to build greater force levels and exert greater influence in this area.

Russia's great interest in exceeding the CFE treaty limits established in this region reflect legitimate security concerns in Central Asia. Inter-ethnic violence in both Georgia and Azerbaijan is caused by Islamic extremists supported by Iran.⁴⁰ Russia fears both Iran, which may have troops in Azerbaijan, as well as Turkey, which share a border with Armenia.⁴¹ The military sees the Central Asian region as Russia's last line of defense against the infusion of arms, drugs, and Islamic extremists.⁴² Loss of control in the area might open the door to the proliferation of these influences into central Russia and Europe.

Ukraine's Perspective. From Ukraine's perspective, the CFE treaty constrains its military forces to specific geographical regions of the country, which effectively prevents the relocation of forces to Ukraine's northern and eastern flanks at a time when Russia's intentions are viewed with skepticism.

Russia's options for resolving this dilemma are few. A formal amendment to change the terms of the treaty can be approved only with unanimous agreement from all of the signatories. Success is doubtful, based on Turkey's consistent objection to repeated Russian attempts to bring relief. Russia might also make a unilateral announcement that it no longer is going to comply with the flank limits. More significantly, Russia could withdraw from the treaty in its entirety.⁴³

C. Recommendations for Action

Russia's formulation of a new doctrine for dealing with security issues in the near abroad poses serious challenges for the United States as Russia deals with the challenges of peacekeeping in local conflict, nuclear nonproliferation, and conventional forces reductions. There are several approaches that the United States might employ in managing these issues.

OBJECTIVE 1: Moderate Russian Influence in the Near Abroad. Russia's activity in the near abroad represents a legitimate attempt to cope with the perceived security vacuum in the region. Russia's approach, however, carries vivid reminders of the strong-arm tactics that were so prevalent in the Soviet era. It is easy to be persuaded that Russian peacekeeping efforts in Central Asia and Moldova are attempts to tie these independent states so closely with Russia that they are in danger of becoming puppets for Russian interests. While Russia can rightfully perceive the threat presented by the Islamic world as reason to strengthen its borders, this method of peacemaking is unfamiliar to many states and creates growing discomfort with Russian actions. There are several steps that the United States can pursue to influence this situation in a positive fashion.

Recommendation 1: Recognize United States has Limited Influence on Russian Peacekeeping Doctrine. The United States must realize that activities within the CIS are out of American purview insofar as they do not affect the international community. It is only when these activities affect the geopolitical stability of the region and impinge on American interests, that the United States must be willing to step in. Further, the United States must be careful to avoid creating a climate where US desires to constrain Russian peacekeeping can give Russia a reciprocal veto on American peacekeeping efforts. Consequently, American influence on Russian peacekeeping efforts is limited.

Recommendation 2: Support Sovereignty of Soviet Successor States. The United States must take a firm stand in protecting the sovereignty of the Soviet successor states. Many of these nations are getting their first exposure to democracy and market economies. As the world's proponent for these institutions as stated in the United States national security strategy, the United States needs to support their implementation in these countries and pursue any political means available to ensure that they have an opportunity to develop unhindered by oppression.

Recommendation 3: Mold Russian Peacekeeping to the United Nations Model. The United States, under United Nations' auspices, might offer Russia an opportunity to learn how to execute peacekeeping operations in the manner acceptable to the rest of the world community. While Russia's ability to use military force is not in doubt, the United Nations needs to emphasize the conditions under which its peacekeepers enter the fray. The best way to approach this may be to conduct military training exchanges and frank discussions of doctrinal differences. Civilian control of the military also needs to be emphasized. While US involvement might take the form of training exchanges, there will be little popular support for the insertion of US troops into actual peacekeeping operations. None should be offered.

Recommendation 4: Act as Neutral Mediator. While there are dangers, the United States might offer to act as mediator in negotiations between the hostile parties of these conflicts. As neutral participants, US negotiators might be able to resolve the differences of the parties without introducing the threat posed by the presence of heavily armed Russian soldiers. While this option does not support Russia's desire to strengthen its presence in the near abroad, it sends a message of US support for the sovereignty of these states.

OBJECTIVE 2: Encourage Nuclear Weapons Control with Financial Aid. There is a role for the United States to assist Russia with the dismantlement of nuclear weapons, provided we ensure that US assistance is not supporting Russian military modernization efforts.

Recommendation 1: Secure Nuclear Weapons in Successor States. The United States has four goals for managing the nuclear arsenals of the Soviet successor states. First, control must be gained over the nuclear weapons that were once under strict operational control. By favoring the return of these weapons to Russian hands, the United States hopes to return them to a secure control system.

Second, both Russia and the United States were interested in proceeding with START implementation as soon as possible, though perhaps for somewhat different motives. For the United States, once the weapons were again under Russian control, reductions could proceed at a pace consistent with treaty stipulations. Russia was concerned that it may be forced to comply with treaty-directed weapons reductions that are unfair because the weapons lost to the other CIS nations are counted in a different manner.

Third, these weapons represented a source of aggression to Russia. The new doctrine clearly addressed the potential for military action with belligerent nuclear powers.⁴⁴ The question remained: did Ukraine's claim to nuclear power membership provide an effective deterrent against aggression by Russia or anyone else? The Nationalistic faction in Ukraine's Rada apparently believed it did.⁴⁵ Russia, threatened by the weapons on its borders, was knowledgeable of Ukraine's limitations on systems operation. The United States might hope to stabilize this situation and prevent outright conflict between the two countries. A more stable environment gives Ukraine a chance to mature as a democratically governed independent state. Russia also might find its southern flank less threatening, thus enhancing regional stability.

Finally, controlling Ukraine's nuclear weapons might prevent proliferation to other countries such as Iran, Iraq, or North Korea. While Ukraine consistently expressed the view that its nuclear components will not be sold, the deterioration of Ukraine's economy increases the incentive to bargain with nuclear weapons in exchange for economic assistance from the United States.

Recommendation 2: Promote Membership in NATO's Partnership for Peace. A recent poll indicated that some 91 percent of those Americans surveyed were not in favor of assisting Ukraine militarily if it entered into hostilities against Russia.⁴⁶ With such low public support, there is little incentive for the United States to offer any significant security guarantees that might involve the use of US troops. Nevertheless, Ukraine is important to US interests in view of its geopolitical position, burgeoning democracy, and fledgling market economy. Likewise,

Russia is important to US security interests given its military capability as well as its potential in the world's economic markets. In the interest of improving stability and predictability, there is good reason to encourage Ukrainian and Russian participation in the Partnership for Peace Program and to conduct training exchanges between Ukrainian or Russian and US military personnel.⁴⁷ Encouraging membership in NATO is inadvisable at this point due both to NATO's stated interests as well as Russian suspicion about NATO expansion.

Recommendation 3: Apply Tailored Economic Assistance to Ensure Follow Through on Nuclear Weapons Agreements. The greatest leverage might come from economic assistance. By 1995, \$1.2 billion in Nunn-Lugar funds will be appropriated for assistance in dismantling the nuclear weapons. Once START and NPT were ratified, \$175 million was to be released.⁴⁸ Access to additional funds was contingent on progress by Russia and Ukraine, as well as Belarus and Kazakhstan, with treaty compliance and weapons reduction stipulations. A further \$277 million of FY94 funds were allotted for defense conversion, elimination of nuclear weapons, export control systems, and accounting and protection systems.⁴⁹ Additional promises of funds are no doubt part of the deal as Ukraine's Rada finally ratified the treaties in November 1994.⁵⁰

OBJECTIVE 3: Encourage Good Will Through the CFE Treaty. The US interest is to use the CFE treaty to reduce conventional forces in Europe at a time when such permanently forward deployed forces are expensive and unnecessary. In spite of the obvious US contribution to the West's intentions, suspicion runs high in Russia about the true western motives in the aftermath of the cold war. Indeed, Russia at times seems almost paranoid about potential NATO growth as former Warsaw Pact countries join the Partnership for Peace. Lack of favor for Russia's perspective can look like both a desire on the part of the West to gain an easy advantage over the Russian military, as well as an attempt on the West's part to mold Russian internal affairs. The question to be faced is: is the West, and the United States as a

contributor, interested in promoting good will with Russia by relaxing treaty flank limits now that the treaty is considered moot by many observers?

Recommendation 1: Relax Limits on Flanks in CFE Treaty to Discourage Russian Withdrawal. The role of the United States must be carefully balanced. As a geographically distant member of NATO, we are not directly threatened by the dispersal of forces in Russia. Thus, US influence is limited on other NATO signatories of the treaty positioned so as to feel threatened. As an outside participant, however, the United States might find a solution amenable to Russia in hopes of warding off any potential violation of or withdrawal from the treaty. Accordingly, US policy must support relaxation of the limits placed upon the northern and southern Flanks in the CFE treaty. The United States should not favor a change in overall treaty weapons limits, but might allow both Russia and Ukraine to position forces within their borders at their own discretion. The United States might remind those NATO member countries that might feel threatened by such a conciliatory change in the treaty that they are still protected by the defensive umbrella of NATO. By casting Russia as a partner rather than as adversary, the United States makes a significant contribution to regional stability.

Notes

1. See James F. Holcomb and Michael M. Boll, *Russia's New Doctrine: Two Views*, US Army War College, *Strategic Studies Institute*, July 1994; Paul H. Goble, "The Russian Military Under the Guise of A Commonwealth," *Washington Post*, July 27–August 2, 1992, p. 24; Prudencio Garcia, "Armed Forces in a Transition from a Totalitarian to a Democratic State," *Voyennaya Mysl*, published in *Central Eurasia Military Thought*, July 1992; James H. Slagle, "New Russian Military Doctrine: Sign of the Times," *Parameters*, Spring 1994, p. 90–91. Broadly speaking, we can observe that Russia's new doctrine rejected Gorbachev's notion of a defensive military by shifting to an "offensive strike" capability and envisioning the possible escalatory use of nuclear weapons. It placed increased emphasis on strategic non-nuclear forces and added new emphasis on technological advancements in command, control, communications, computers, and intelligence, smart weapons, and mobility. Finally, it articulated support for the plight of ethnic Russians in other CIS states.

2. See William D. Jackson, "Imperial Temptations: Ethnicities Abroad," *Orbis*, Winter 1994, pp. 1–15, for background on ethnic Russians living abroad.

3. See John W.R. Lepingwell, "The Russian Military and Security Policy in the 'Near Abroad'," *Survival*, Vol. 36, No. 3, Autumn 1994, pp. 70–92.

4. *Ibid.*, p. 71.

5. Roy Allison, "Military Forces in the Soviet Successor States," *Adelphi Paper 280*, London: International Institute for Strategic Studies, October 1993, p. 10.

6. *Ibid.*, p. 11.

7. *Ibid.*, pp. 23–24.

8. Lepingwell, p. 74.

9. *Ibid.*, p. 74.

10. *Ibid.*

11. See Douglas Clarke, "Military Affairs, The Russian Military, and the CFE Treaty," *RFE/RL Research Report*, Vol. 2, No. 42, October 22, 1993, p. 41, for reports that Turkey remains a cause for concern given both historical tensions and current discord over the status of conventional forces.

12. See Michael Orr, "Peacekeeping - A New Task for Russian Military Doctrine," *Jane's Intelligence Review*, July 1994, pp. 307–309.

13. *Ibid.*, p. 308. He calls for close links and full cooperation with the local civil administration, law enforcement, and internal troops. Their actions should be firm and timely to control events relying on negotiation rather than force, but the troops should not hesitate to use stronger measures when necessary. General Vorob'yev goes on to classify these stronger measures initially as reconnaissance, followed by patrols, cordons, and road control, and then forceful measures such as locating, disarming, and neutralizing armed bands. These operations include ground and combined arms sweeps, cordons and search operations, and various forms of strikes conducted by specially formed detachments of troops.

14. *Ibid.*, p. 309.

15. See Lepingwell, pp. 75–81, for details of the following summary of Russian peacekeeping activity in the near abroad.

16. Lepingwell, p. 81.

17. See Michael Ruhle, et. al., "Partnership for Peace: A Personal View from NATO," *Parameters*, Vol. XXIV, No. 4, Winter 1994–95, pp. 66–75, for a review of the Partnership for Peace Program and its relationship to Russia; also Ronald V. Dellums, "Peace Through Partnership," *Mediterranean Quarterly*, Vol. 5, No. 3, Summer 1994, pp. 1–8.

18. *Ibid.*
19. "Warnings from Massandra," *The Economist*, September 11, 1993, p. 52.
20. See "Black Sea Fleet Negotiations," *RFE/RL Research Report*, Vol. 3, No. 33, 1994, p. 7.
21. See Taras Kuzio, "Ukraine's Military Industrial Plan," *Jane's Intelligence Review - Europe*, August 1994, p. 352, for a detailed account of Ukraine's military industrial complex.
22. Author interview in Moscow, September 1994.
23. It is important to note that Chechnya is an internal region within Russia, not part of the "near abroad." As such, application of Russian military force is considered in a different light — that of internal civil war — than the peacekeeping context addressed elsewhere in this chapter. This section is included only to provide insights into the effect of this situation on the Russian military and its leaders.
24. See "Chechnya's Challenge to Russia," *IISS Strategic Comments*, Vol. 1, January 17, 1995, for an analysis of the impact of the Chechnya situation on the Yeltsin government. Also, see "Yeltsin Threatens Action on Warring Secessionist Area," *New York Times*, November 30, 1994, p. A3.
25. See Blank and Tilford, *Russia's Invasion of Chechnya*.
26. "Spoils of Peace," *The Economist*, March 21, 1992, p. 53.
27. See Steven Woehrel, "Ukraine: Nuclear Weapons and US Interests," *CRS Report to Congress*, March 15, 1994, pp. 1–5, for a detailed summary of the events surrounding Ukraine's position on the nuclear weapons issue. Also see William C. Martel and William T. Pendley, *Nuclear Coexistence: Rethinking US Policy to Promote Stability in an Era of Proliferation*, Montgomery, AL: Air War College Studies in National Security, No. 1, 1994, especially Part III; Serhiy Tolstov, "International Factors of Nuclear Disarmament of Ukraine," *The Ukrainian Review*, Spring 1994, Vol. XLI, No. 1, pp. 5–21. In a decision at Alma-Ata, Kazakhstan, on December 21 1991, the four CIS states agreed to ratify START I. Belarus and Kazakhstan agreed to join the NPT as non-nuclear states and to transfer their tactical nuclear weapons back to Russia by July 1, 1992. Command and control of the strategic nuclear weapons was placed in the hands of the Russian president whose employment decisions would be subject to the agreement of the leaders of Ukraine and Belarus. Ukraine, however, was not an enthusiastic supporter of the NPT, and in fact Ukrainian distrust of Russian intentions and a growing desire to use the issue to help resolve economic and political problems threatened to undermine Russian-Ukrainian relations. Russia argued that the weapons rightfully belong to Russia, since the knowledge and wherewithal to employ them were the products of the former Soviet Union. Both nations saw nuclear weapons as a relatively inexpensive form of defense in contrast with the cost of standing conventional forces. Senior Ukrainian

officials see nuclear weapons as a means of gaining status in the international community and as a tool for securing aid from both Russia and the United States. Author interview in Kiev, Ukraine, September 1994.

28. Woehrel, p. 2.

29. *Ibid.*, p. 4.

30. Author interview in Kiev, September 1994.

31. Woehrel, p. 7.

32. *Ibid.*, p. 7.

33. See Sergei Kiselyov, "Ukraine: Stuck With The Goods," *The Bulletin of the Atomic Scientists*, March 1993, p. 32.

34. Woehrel, pp. 8–11.

35. "Achievement in Ukraine," *The Washington Post*, November 18, 1994, p. 26.

36. "Ukraine Votes to Become a Nuclear-Free Country," *New York Times*, November 17, 1994, p. A6.

37. *Ibid.*

38. See Clarke, pp. 38–40, for a superb review of the effects of the CFE treaty on Russia.

39. Lepingwell, p. 71.

40. Clarke, p. 41.

41. *Ibid.*, p. 41.

42. Neela Banerjee, "Russia Combines War and Peace to Reclaim Parts of Its Old Empire," *The Wall Street Journal*.

43. Clarke, p. 43.

44. Slagle, p. 90.

45. Author interview in Kiev, September 1994.

46. See Catherine M. Kelleher, "Soldiering On," *The Brookings Review*, Spring 1994, p. 27.

47. See Michael Ruhle, *et. al.*, "Partnership for Peace: A Personal View from NATO," for more on the Partnership for Peace Program.

48. Woehrel, p. 19.

49. *Ibid.*, p. 19.

50. James Rupert, "Ukraine Joins Pact on A-Arms," *The Washington Post*, November 17, 1994, p. 1.

Chapter 13

Russia and the Commonwealth of Independent States: Impediments to Democratic Reform

by Michael M. Boll

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- A. The Problem
 - B. Disintegration of the CIS
 - C. Reintegration of CIS
 - D. Challenges to Regional Stability
 - E. Recommendations for Action
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A. The Problem

The success of democratic reform in Russia relates directly to the political, economic and strategic environment in Eurasia. While the demise of the Soviet Union is attributed to unresolved problems from the Soviet era, the dissolution of former frontiers largely recast these issues in new form. More than 70 years of the Soviet empire, with deliberate efforts to integrate and equalize political and economic issues, does not alter the numerous ties and dependencies among the newly independent states. Thus, the hope that we will see stability and democracy in Russia and Eurasia depends upon resolving Russia's relationship with the successor states.

Russia's relationship with its neighbors is not unique, as history is replete with examples of former imperial powers failing to evolve positive relations with both their successor states, and their immediate neighbors resulting in chronic instability and movements toward totalitarianism. Surely the economic dependence between Russia and the other former Soviet States is as intense as that which held between Austria and the remaining

components of the Austro-Hungarian Empire prior to its dissolution in 1918. It is obvious that Russia must resolve the problem of the relationship with the Soviet successor states if stability and democracy are to prevail in Eurasia.

The birth and development of the Commonwealth of Independent States (CIS) offer the most visible framework for creating regional stability. This chapter examines the evolution of the CIS in order to provide a framework for stability in Eurasia, argues that a strictly nationalist approach to Russian policies in the region is counter-productive, and concludes with recommendations for implementing a security framework.

B. Disintegration of the CIS

Birth of CIS. The birth of the CIS occurred in early December 1991, following an emergency meeting of the Presidents of Russia, Belarus, and Ukraine in the aftermath of the failed coup against President Gorbachev. The immediate cause was the Ukrainian declaration of independence on December 1. Within weeks, however, geopolitical realities prompted an expansion of the membership to include other Soviet republics. The fact that Kazakhstan shares a three-thousand-mile border with Russia and has a slavic minority approaching 45 percent of the population made accession imperative. Similar ethnic, economic and political ties compelled many of the other Soviet successor states to opt for the same solution. Thus by the beginning of 1992, a total of 11 former Soviet republics had concluded that membership within the new organization was in their best interests.

The fact that the CIS was formed prior to the actual dissolution of the Soviet Union clearly influenced its initial structure. With twelve diverse republics, each at a different stage of internal political consolidation, divergent views about the purpose of the CIS were inevitable. As a result, initial efforts designed to create effective coordinating structures remained incomplete. Ruling Councils of Heads of State (Presidents) and of Heads of Government (Prime Ministers) were provisionally approved, in addition to the creation of a common economic space. While all strategic forces were to remain under a unified command

subordinated to the Council of Heads of State, there was no agreement on which units were bound by this mandate. A subsequent meeting of CIS representatives agreed that each Republic might form its own army.¹

Economic Disintegration. By the spring of 1992, many wondered whether the CIS could survive.² The obvious stagnation within the CIS was balanced by activity within the new republics in response to the emergence of myriad national problems. But the central problem was economic. The 70-year debacle of communist mismanagement left visible traces in the Russian economy and those of the successor states. By 1991, all of these states faced the prospect of economic collapse. The statistics for the economic disintegration in Russia are particularly grim.³ For the members of the CIS, their economies experienced a decline in gross domestic product of 11 percent in 1993 and 16 percent in 1994.⁴

The Yeltsin government implemented remedial policies which combined economic stabilization with efforts to liberalize prices. Ever mindful of the positive results of "shock" therapy in Poland, and aware of International Monetary Fund (IMF) guidelines for badly needed loans, the Russian government presented a nearly balanced budget to the legislature which required major reductions in defense, investment and subsidies to state-owned industries. A reformed tax structure was mandated, including a new 28 percent value added tax. And to revitalize trade, earlier restrictions on firms specializing in foreign exchanges were modified and a system for issuing import and export licenses was accepted. Further, price controls were lifted in January 1992.⁵

Toward Common Military Policy. The emphasis on economic issues soon was matched by a similar approach to military policy. The large number of Russian troops left outside the new Russian frontiers, combined with the continuing problems of draft evasion and insufficient defense funding, fueled desires to centralize control over all CIS military within the Russian government. While the initial plan was to subordinate Russian forces to the anticipated common CIS joint command, Ukraine's declaration of its readiness to establish its own armed forces dashed this hope in early 1992. In May 1992, Russia followed suit,

naming Pavel Grachev as its first Minister of Defense. And by the fall of 1992, Russia appointed commanders for the ground, strategic-rocket, air defense, and naval forces.⁶

In parallel with efforts to reorganize the military, the Russian government used bilateral military ties with other CIS states to manage common security problems. In May 1992, Russia and Kazakhstan agreed to the creation of a single strategic zone which provided for joint control of the common air space and defense facilities of both republics. Two months later, Russia and Turkmenistan agreed that the emerging Turkmen forces would be trained through a joint Russian-Turkmen command, while air force and air defense units were placed under Russian command. Uzbekistan-Russian accords also foresaw extensive cooperation along the Central Asian frontier. Kyrgyzstan accepted the formation of joint Russian-Kyrgyz forces, and Tajikistan signed a friendship and defense agreement with Moscow that legitimized the crucial role of the Russian 201st Motor Rifle division in the struggle along the Afghan-Tajik border.⁷

Toward Common Foreign Policy. The new emphasis on economic and military affairs was matched by Russian efforts to establish and thereby dominate a common CIS foreign policy. President Yeltsin and Foreign Minister Andrei Kozyrev boldly proclaimed Russia's primary task was to join the "civilized" world, and emphasized close ties with the United States and the other G-7 nations. Because the CIS was unable to overcome the forces which had destroyed the USSR or to convince CIS members to see Russia as the leading state in the CIS, many observers concluded that the CIS would die stillborn.⁸ As Western observers pronounced the demise of the CIS, the Yeltsin government began a dramatic reconsideration of the organization's potential. In part this reexamination arose from growing Russian disappointment with the meager foreign aid available to support Russian efforts to align its domestic and foreign priorities with those of the West. In part, Russia's continuing economic crisis fueled desires to achieve broader regional integration.

CIS Economic Crisis. Despite efforts to liberalize prices and stabilize state spending, the economies in Russia and the CIS

states were in a crisis at the end of 1992. As inflation devalued the Russian ruble throughout 1992 and the exchange rate climbed from 170 to the dollar at the end of 1991 to nearly 500 to the dollar in 1992, Russian economists realized that the economic policies of the other CIS states weakened the Russian economy. By the end of 1992, Moscow had a trade surplus with other CIS states of 300 billion rubles.

The initial CIS agreements of 1991 did not limit the ability of member states to subsidize their own inefficient industries by unlimited creation of credits in rubles. These credits gave rise to large flows of currency which were re-exported to Russia, thus exacerbating inflationary pressures. In July 1992, the Russian Central Bank decreed that contracts between Russian and CIS firms would be honored only if the given CIS republic or enterprise held a currency surplus in the Russian Bank itself.⁹ But such measures were not even an effective stopgap given the economic dependence among CIS members arising from the Soviet past.¹⁰ Thus, the impact of the Central Bank's decision was even more dramatic upon the remaining republics, given that a disruption of trade among CIS members would shrink Russian consumption by one-third, while producing equally devastating results in the other republics.¹¹ Undoubtedly, the close connection between Russia's economic welfare and the fate of the remaining CIS republics motivated President Yeltsin to proclaim that the CIS could transform itself into a free-market economy.¹²

Russian Minorities. A further issue which fueled concerns about Russia's role within the CIS is the treatment of the Russian-speaking minority remaining within the CIS republics. According to Russian estimates, this minority encompasses slightly over 25 million people, with 11 million (45 percent of the total diaspora) in Ukraine and just over 6 million (24.6 percent of total Russians in the CIS) in Kazakhstan. Although these two republics account for about 70 percent of the total, there are significant groups of Russians in the smaller republics as well. For example, the 475,000 Russians represent about 30 percent of the indigenous population in Estonia, while in Latvia the 906,000 form

about one third of the population. Russian minorities of one million or more live in Belarus and Uzbekistan.¹³

The dispute about the rights of Russian minorities ignited when the Baltic republics drafted new codes of citizenship after their declarations of independence in 1991. In Estonia, a land which experienced extensive forced migration of Russians into the Republic following its annexation in 1940, laws were passed restricting citizenship to inhabitants of the republic prior to 1939 and their descendants.¹⁴ Because neither of these states chose to adhere to the CIS, Moscow's response to alleged infringement of Russia rights was strictly bilateral. The existence of Russian military forces remaining in these two republics exerted pressure on CIS governments. But these disputes worried nationalistic Russians about any possible infringement of the rights of Russian minorities in the successor states.¹⁵

The initial Russian response to protecting its minority abroad involved political warnings, refusals to withdraw Russian troops pending a satisfactory solution, and efforts to negotiate agreements with individual states. President Yeltsin specifically chastised Latvia in this regard.¹⁶ While Yeltsin moderated his rhetoric somewhat, Russian policy combined bluster and negotiations when dealing with Russian minorities in the Crimea. Attempts were made to achieve bilateral agreements with the separate republic which might grant their Russian speaking inhabitants some form of special protection, but only the Turkmen Republic signed provisions granting dual citizenship.¹⁷ Perhaps the clearest expression of Russian concern in this matter was the prominent attention that Russian minorities received in Russia's new military doctrine.¹⁸

Toward Military Stability. One challenge for Russia and the CIS members is to insure military stability along Russia's new frontiers. Unfortunately, Russian troops are involved in political, religious, and ethnic disputes in Tajikistan, Moldavia, Georgia, and Azerbaijan. The problem is that Russian pressures to establish a common security framework in the former Soviet strategic space raises questions about the sharing of military burdens among CIS members. There already is evidence that, absent an effective

security relationship, CIS states might fall under the influence of foreign powers or Russia itself, or fuel concerns of military threats to Russia.¹⁹

It is evident that Russia cannot resolve these security problems within the CIS through strictly bilateral relations. And when coupled with growing disappointment about meager Western economic aid, Russia is witnessing a backlash against the early, naive hopes for simple solutions to economic reform. By the end of 1992, Russian political culture seemed to show some signs of stability, as evidenced by the functioning if strident parliament and government. Amidst this turmoil, Russia is shaping a new world view. First, Russian foreign policy will defend its national interests without taking special consideration of Western views. Second, this means that the highest priority is the relationship with the former Soviet republics within the loose organization of the CIS. Third, Russia must balance its relationship with Europe and the United States, since American influence may decline and the power of Europe may grow. And finally, Russia's initial emphasis on peaceful resolution of existing problems will be tempered given the range and nature of issues requiring resolution to ensure Russian stability.²⁰

C. Reintegration of CIS

Russia's politicians quickly emphasized integration between Russia and the CIS member states in order to solve the problems created by the demise of the Soviet era. For example, addressing the centrist "Civic Union" in early 1993, President Boris Yeltsin called upon the international community to recognize Russia's special role in the CIS community.²¹ Later, at a meeting of CIS Heads of State, Yeltsin demanded the creation of institutions capable of resolving conflicts in the context of a CIS security system.²² Finally, in April 1993, Yeltsin announced that earlier critics who had seen the CIS as merely a means of "civilized divorce" had misjudged the organization's potential. Yeltsin's pronouncements of Russia's desire to increase the degree of cooperation through the CIS was evident with the establishment of a CIS Charter.

CIS Charter. The Charter adopted at a meeting of CIS Heads of State in Minsk in January 1993 sought to set guidelines for future integration.²³ The rhetoric promises to protect the rights and basic freedoms of man — an issue of deep interest to Moscow in view of the extensive Russian minority abroad — and to establish common foreign and economic policies toward outside states and organizations.²⁴ The administrative organs of the strengthened union include the Council of Heads of State, and Heads of Government, a Council of Foreign Ministers, and Economic Court, a Coordinating-Consultative Committee, a Commission on Human Rights and various committees dealing with economic cooperation among diverse branches of industry.²⁵

The new Charter also establishes a CIS Interstate Bank to facilitate payments among members and thus enhance trade. While each state has one member on the ruling bank board, Russia retains 50 percent of the vote. The ruble will be the official currency of the CIS, and the Russian Central Bank will control printing rubles, while taking the concerns of individual members into account. The Bank also will coordinate the monetary and credit policies of its members.²⁶

Defense Policy. There is some agreement on defense policy. In view of the instability and conflict in Tajikistan, there is agreement to dispatch frontier troops from the other republics to strengthen existing Russian contingents. This initial understanding was supplemented later at a Conference of Heads of State from Russia, Kazakhstan, and the Central Asian Republics in Moscow which focused on the issue of frontiers between Tajikistan and Afghanistan. Increased multilateral assistance for Tajikistan was approved as was a joint call for United Nations and Conference of Security and Cooperation in Europe (CSCE) assistance in mediating the border dispute.²⁷ Finally, a meeting of Defense ministers established a common headquarters to coordinate military activities between CIS members in Moscow, with Russia paying half of its anticipated expenses.²⁸

The resolutions on common security problems drafted by the Council of Heads of State fell short of assuaging Russian concerns over instability in the Soviet successor states. By early 1994, tens

of thousands of Russian troops remained outside its borders, often engaged in local hostilities. Thus, 12,000 officers and soldiers serve in the Black Sea Fleet, whose ownership is disputed between Russia and Ukraine; 25,000-30,000 are stationed in Belarus; the 14th Army is quartered in Moldavia; 9,000 are in Armenia, 24,000 in Tajikistan, 5,000 in Uzbekistan, and smaller numbers in other republics.²⁹ While there is some cooperation among the CIS states to reduce Russia's "peacekeeping" operations, Moscow is not satisfied. In Tajikistan, for example, contingents from Kazakhstan, Kirgizia, and Uzbekistan served side-by-side with Russian troops, but their numbers were less than half those promised earlier.³⁰

In July 1994, a meeting of the CIS Council of Ministers, representing the nine signatories of Tashkent Collective Security Agreement convened in Moscow, to approve the Framework for Collective Security. The intent was to increase cooperation among CIS military units, create both national and joint forces, and construct joint anti-aircraft defenses.³¹

Economic Cooperation and Concerns. Another element of the 1993 CIS Charter established a framework for still nascent efforts to promote economic integration and development. We note that from the beginning problems between CIS states posed barriers to closer interaction.³² Despite these problems, Russia leads in efforts to create an integrated CIS economic market. In May 1993, a meeting of the Heads of CIS States in Moscow announced that draft statutes for an economic union were under active consideration.³³ But growing concerns that Russia was moving too rapidly fomented complaints about the pace and form of economic integration. For example, Moldavia and Turkmenistan objected that the term "union" was too reminiscent of the Soviet era. In July 1993, Russia, Belarus, and Ukraine declared the establishment of a comprehensive economic forum, and pledged broader cooperation in defense.³⁴

The thinly-veiled threat by the Slavic republics to operate alone produced a quick response among remaining CIS members. In July, the presidents of Kazakhstan and Uzbekistan protested efforts for a separate Slavic common market and called for rapid

implementation of unity throughout the organization.³⁵ The resulting Moscow meeting produced a step-by-step plan for full economic integration in four stages.³⁶ It was surprising, given discontent within the CIS members, that nine CIS members signed the agreement, while Ukraine and Turkmenistan acceded as associate members. Thus, another key stage in the movement to economic integration was achieved.

Foreign Policy Integration. The increasing unity among CIS states, and Russia's realization that its future is tightly intertwined with that of democracy and stability in Eurasia, accelerated efforts to enhance the international status of the CIS. In December 1993, the CIS announced that as a functioning international organization it demands recognition by the international community.³⁷ At the same meeting, the CIS asked the United Nations to grant the CIS status as an international organization. Russian Foreign Minister Andrei Kozyrev asked the United Nations Secretary General to grant observer status to the CIS in the General Assembly. Kozyrev also asked other European organizations to recognize the CIS, "as a regional structure," suggesting that the CIS participate in the peacekeeping efforts of the Conference on European Security and Cooperation in Europe (CSCE, now OSCE).³⁸

Signs of "Cold Peace." Perhaps the clearest warning of Russian interest in using CIS integration to shape a security order in Eurasia occurred in the CSCE summit meeting in Budapest in December 1994. President Yeltsin accelerated worries in the CIS and foreign capitols that NATO's expansion to the east might create a "Cold Peace." President Yeltsin did not assuage concerns when he argued that instead of NATO, the states of Eurasia should use the CIS as the pillar of European security.³⁹

D. Challenges to Regional Stability

At the time of this writing in the spring of 1995, it is clear that predictions about the likely demise of the CIS were pessimistic. There are signs of progress in integrating the economic, military, and political structures of the member states. In Ukraine, election of Leonid Kuchma in the summer of 1994 suggests that even a

recalcitrant participant in the CIS might become a steadfast member.⁴⁰ Kuchma's orientation toward the CIS reflected the collapse of Ukraine's economy amidst the failure to implement economic reform. Thus, Kiev sees closer integration within the CIS as a means of economic survival.

Challenges of Economic Integration. The issue of economic integration is vastly more complex than Ukraine's case suggests. There remain serious incompatibilities among the economies of 12 states with specific problems.⁴¹ The existence of imbalances in intra-republic trade highlights the difficulties of integration among diverse economies. Successful integration will require radical economic reform within the CIS states as well as Russian economic assistance. Russia must take the lead by managing in economic reform in Russia as well as the less developed neighbors.

The problem is that Russia can hardly afford such assistance. While the Russian government worked out a three-stage plan of economic development and change running out to the year 1996, it is unlikely that the Russian economy will be stable or that privatization will be complete. Russia, for now, hopes that the state's share of the gross domestic product will decline to 30 percent; that in 1996 Russia will focus on technological reconstruction and improving the standard of living; and that by the end of the century, Russia's yearly rate of economic growth might approach 4 to 5 percent.⁴² It is difficult to believe that Russia will make such progress in several years, given political struggles in Russian society, the debacle in Chechnya, and growing Western impatience with Russia's shift toward authoritarian government.

Impediments to CIS Integration. Several Russian observers have questioned the prospects for CIS integration given the realization in Moscow that Russia's internal problems during economic and democratic transitions imperil hopes of closer ties with the former Soviet republics.

In the fall of 1994, Evgenii Primakov, director of the Russian Federation Foreign Intelligence Service (successor to the KGB), summarized concerns about CIS integration. The economic realm is most problematic. While Primakov cited numerous factors promoting integration, integration is not seen as inevitable by the

Intelligence Service.⁴³ While Russia continues to make progress in political and economic reform, it still faces numerous challenges. And the success of these efforts determines to a large extent the fate of the CIS.

E. Recommendations for Action

There are several objectives that the United States must consider as it shapes policies for dealing with Russia and the CIS.

OBJECTIVE 1: Decrease Prospects for Disintegration within Russia and CIS Members.

Recommendation 1: Remove Barriers to CIS Political Integration. The impediment to greater cooperation among CIS members stems from undeveloped rules governing political discourse, and their inability to organize themselves into factions with clear notions of their own interests. The West accumulated considerable experience with positive political interaction in difficult situations. The challenge is to use organizations to train emerging CIS political elites to negotiate their differences and thus to achieve stable relationships. The United States should encourage delegations of key members from the public and private sectors to visit the CIS states and bring representatives of the CIS leadership to the United States. Foreign delegations of parliamentarians, trade union leaders, academicians, and attorneys might benefit from exposure to western practices. A corollary is for various institutes and councils representing various economic, social, and political groups in the United States to establish affiliates within the CIS. Typical of such organizations are the AFL-CIO, the American Bar Association, and the Chamber of Commerce.

Recommendation 2: Promote Economic Integration within the CIS. The purpose of economic integration is to minimize the prospects of economic collapse within the CIS member states. Until these states learn to reverse the inefficient economic practices learned from 70 years of central economic

planning, they face the prospect economic disintegration. The problem is that the collapse of any single economy will create social, ethnic, and religious strains that will undermine that state and its neighbors. The United States needs to promote coordinated economic development in order to diminish the risks that tribal and ethnic disputes within the CIS republics located in Central Asia and the Caucasus region will explode. Accordingly, the United States needs to promote economic assistance within the CIS area and encourage economic integration.

Recommendation 3: Build CIS Marshall Plan. The United States needs to consider the creation of a Marshall Plan to accelerate economic integration, specialization, division of labor, and the development of natural resources. This is not a plea for large scale assistance, given that the political climate in Washington and uncertainties in the CIS states. The United States might develop a program similar to that of the European Recovery Program. The program could encourage each CIS republic to organize a general plan for economic development which emphasizes the economic sectors in which growth depends on exchange and investment among the CIS members. The CIS member states also will benefit from the establishment of a convertible currency using either the Russian ruble or some combination of national currencies and a common unit of accounting capable of serving as a temporary means of adjusting export and import balances. The International Monetary Fund is one sponsor for such a program, and future loans might be tied to implementation.

OBJECTIVE 2: Enhance the International Status of the CIS. It is essential to establish the stability of the CIS as a mechanism for promoting stability in the region. One approach is to grant special status to the CIS as a regional organization that is responsible for maintaining stability in the region.

Recommendation 1: Establish the CIS as an International Organization under United Nations Rules. The political and economic integration of the CIS can be promoted by acknowledging its special rights and responsibilities for regional stability. It is

evident that CIS joint forces are active in Central Asia and the Caucasus, and observers from the Organization for Cooperation and Security in Europe (OSCE) are present in at least one state. While the United States and other Western states are hesitant to commit troops to this region, nonetheless many nations in the region believe that Russia seeks to reclaim dominance in the region. Thus, the CIS emerges as the sole instrument for insuring regional stability in this portion of the world. There are strategic advantages for states outside the CIS to recognize the value of the CIS for maintaining security in this region.

However, we must acknowledge that granting special responsibilities to the CIS carries risks. But in the absence of a better alternative, the CIS offers the best answer to containing Russian ambitions in the region. There is little doubt that Russia will continue to exercise a dominant role within the CIS in view of its economic power and borders with the adjacent CIS states. Yet this factor might work to the advantage of world peace. One must recall that plans for postwar stability drafted prior to the cold war called for regional hegemony exercised by four, then five states. Each state was to harmonize its regional interests and demands through an international body known as the United Nations. This plan, long postponed by the disruption of East-West relations following 1945, might find new expression today. Perhaps a Russian-dominated CIS, closely integrated within existing international bodies, could maintain regional and world stability.

Notes

1. See Roy Allison, "Military Forces in the Soviet Successor States," *Adelphi Paper No. 280*, London: International Institute for Strategic Studies, 1993, pp. 9–10.

2. See Ann Sheehy, "CIS: A Shaky Edifice," *RFE/RL Research Report*, Vol. 2, No. 1, January 1993, p. 38, for the view that "the CIS summits were invariably preceded by gloomy prognostications about whether the forthcoming summits would be the last. The differences between members... seemed so acute that many doubted that the commonwealth would survive."

3. See John Tedstrom, "Economic Crisis Deepens," *RFE/RL Research Report*, Vol. 1, No. 1, January 3, 1992, pp. 22–26, for the following data on the collapse of the Russian economy. In the first three quarters of 1992, oil production declined 10 percent, coal was off 11 percent, and coking coal

diminished 20 percent over a year prior. Overall industrial production fell nearly 7 percent over corresponding months in 1990, accompanied by severe disruptions in the normal pattern of wholesale and retail exchange. Agricultural output declined as well despite initial suggestions of a bumper crop. Eighteen percent of the potato fields remained unharvested as did 47 percent of the vegetables. In the first nine months livestock and poultry production declined by 12 percent with equivalent decreases for eggs and other products. Foreign trade, long a source of vitally needed industrial goods from the West fell 38 percent, with imports off by over 45 percent. Finally, the money supply increased 118 percent in the first nine months, which was a harbinger of an inflationary crisis.

4. See "Postscripts," *Wall Street Journal*, February 7, 1995, p. A19.

5. Michael Ellman, "Shock Therapy in Russia: Failure or Partial Success?" *RFE/RL Research Report*, Vol. 1, No. 34, August 28, 1992, pp. 48-62.

6. Allison, p. 18.

7. *Ibid.*, pp. 57-58.

8. See Ann Sheehy, "The CIS: A Shaky Edifice," *RFE/RL Research Report*, Vol. 2, No. 1, January 1, 1993, p. 37, for the view that "The first year of the existence of the Commonwealth of Independent States (CIS) was marked by serious doubts about whether the new body was viable. A year after its creation the CIS was still an amorphous body that had not yet adopted a charter. It also lacked structures to ensure that the numerous treaties ... would be implemented." Also see Martha Brill Olcott, "Russia's Place in the CIS," *Current History*, October 1993, p. 314, for the view that, "As the Commonwealth of Independent States (CIS) approaches its second anniversary, it seems likely that this virtual phantom of the international stage will disappear entirely, without ever having defined its shape or function."

9. See Philip Hanson, "The End of the Ruble Zone?" *RFE/RL Research Report*, Vol. 1, No. 30, July 24, 1992, pp. 46-48; Eric Whitlock, "The CIS Economy," *RFE/RL Research Report*, Vol. 2, No. 1, January 1, 1993, pp. 46-49.

10. See Bruce D. Porter and Carol R. Saivetz, "The Once and Future Empire: Russia and the 'Near Abroad,'" *The Washington Quarterly*, Vol. 17, No. 3, Summer 1994, p. 78, for data on Russia-CIS economic exchange: "In the late Soviet period, most republics exported approximately 50 percent of their net material products to other republics and imported around 40 percent; the comparable Russian figures were approximately 18 percent both for imports and exports."

11. Iu Oleshchuk, "Novaia Rossia i integratsionnye tendentsii v SNG," *Mirovaia Ekonomika i Mezhdunarodnye Otnosheniia (hereafter MEMO)*, April 1994, p. 84.

12. See "Eroeffnungsrede des russischen Staatspraesidenten, Boris Jeltsin...." in *Dokumente zur russischen Aussenpolitik und zur Entwicklung in der Gemeinschaft Unabhaengiger Staaten (GUS)*, *Europa Archiv*, Vol. 49, No. 11, October 6, 1994, p. D355, for Yeltsin's view that, "The majority of the citizens of the CIS lands, practically all far-sighted politicians understand that only together, on the basis of integration, are we in a position to overcome the difficulties of the transition to a market economy. Simultaneously, we must resolve the three key issues: the principles of economic cooperation, the stages in the movement to an economic union, and the organizational forms of cooperation."

13. Anatoli Vishnevskii and Zhanna Zaionchkovskaia, "Volny Migratsii. Novaia Situatsiia," *Svobodnaia mysl'*, No. 12, 1992, p. 6.

14. See Riina Kionka, "Estonia: A Difficult Transition," *RFE/RL Research Report*, Vol. 2, No. 1, January 1, 1993, pp. 91-99; and Dzintra Bungs, "Latvia: Toward Full Independence," *op. cit.*, pp. 96-98. Residents of Estonia who do not qualify under these terms but wish to gain full rights, must reside in independent Estonia for two years, wait an additional one-year, and demonstrate competency in the Estonia language. In Latvia, the law of October 1991, enfranchised only individuals residing in the republic prior to Soviet annexation and their descendants. Others would have to await further legal enactments concerning their possible rights to apply for citizenship.

15. See Vishnevskii and Zaionchkovskaia, p. 5, for reports that "between 1959 and 1988, the number of Russians in Georgia declined by 18 percent, in Azerbaijan the number fell by 22 percent in the 1970's alone. In the second half of the 1980's the migration of Russians from Central Asia assumed major proportions. And by the end of that decade, ethnic disputes in the Caucasus and Central Asia led to the first wave of people who were expelled while seeking protection in the Russian republic. Thus, in April 1992, 73,500 Russians were officially registered as 'compelled to abandon their place of regular inhabitation' beyond the border." And beginning with the 1960's, a steady migration of Russians who had returned from the non-Russian republics brought stories of discrimination.

16. See Maksim Yusin, "Boris Yeltsin Threatens Latvia," *The Current Digest of the Post-Soviet Press*, Vol. 46, No. 38, 1994 p. 19, when as recently as the fall of 1994 Yeltsin argued that, "Latvia has chosen to divide the country's residents into first and second class people and has legitimized discrimination on ethnic grounds... Russia cannot tolerate a situation in which hundreds of thousands of ethnic Russians have been put in a humiliating situation in a neighboring country."

17. See Olga Alexandrova and Heinrich Vogel, "Russlands Politik gegenueber dem 'nahen Ausland'," *Europa Archiv*, Vol. 49, No. 5, October 3, 1994, p. 137.

18. See "Osnovnye polozheniia voennoi doktriny Rossiiskoi federatsii," *Izvestiia*, November 18, 1994, p. 1, for the discussion on the "Fundamental Existing and Potential Sources of Military Danger Outside the Russian Federation," which included "suppression of the rights, freedoms and the legal interests of citizens of the Russian Federation in the states beyond the frontier."

19. See I. Prokhorenko, et. al., "Konflikty v SNG: nekotorye voprosy metodologii issledovaniia," *MEMO*, August 9, 1994, p. 71, for the argument by a researcher at the Moscow think-tank IMEMO: "Using the example of the Caucasus region we see that the permanent situation of conflict (between Azerbaijan and Armenia and in Georgia) is leading to the complete exhaustion of the economic potential of the states, sociopolitical chaos and national degradation. And if in the near run Russia proves herself unable to play the peace-creating role, she may lose her military-political position and her place will be taken by the southern neighbors of the Caucasus republics (Iran, Turkey, Pakistan which more and more evidently are activating their foreign policies in this direction). It is thus not possible to leave out of calculation even those destabilizing influences with far reaching negative consequences which military activities in this region exert on the situation in the southern regions of Russia."

20. See Renee de Nevers, *Russia's Strategic Renovation*, Adelphi Paper 289, July 1994, pp. 30-31. Also see I. Prokhorenko, p. 70, for the argument that "Russia is attempting to be confirmed in the role of the peacemaker, first of all within the confines of the CIS. The foundation for this position is derived from the historical, cultural and economic traditions of Russian domination of the entire geopolitical space of the former USSR. The resolution of most regional problems and contradictions is impossible without the assistance of Russia. In the first place, Russia and the other republics are narrowly interconnected and mutually supplement one another in the economic sphere. Destruction of the integrity of the national-economic complex hit hard the economies of all former subjects of the USSR. Second, the territory of the Soviet Union represented a single, military-strategic space. Third, Russia was always the source of scientific and scientific-technological progress for the other republics. Fourth, Russia and her partners in the CIS possess a common tradition of development, a similar system of social relations, and thus common problems on the way to entering a market economy. Fifth, the policies for the cultural development of our nations via their drawing together which, in the course of decades were conducted by the Bolsheviks, were done through the means of the Russian language and Russian culture, which engendered a common 'cultural space' and a similar mentality of the participants in this process. Thus Russia cannot desert the republics, cannot avoid assistance in the solution of their problems, in particular in regional conflicts, especially in the coming years."

21. See *Izvestiia*, March 4, 1993, for Yeltsin's comment that the "time has arrived when the international organizations must grant Russia special powers as the grantor of peace and stability on the territory of the former [Soviet] Union."

22. See Boris Meissner, "Die GUS zwischen Integrationsplaenen und Krisenerscheinung," *Osteurope*, September 1994, p. 838, when Yeltsin appealed to the CIS states to form a common position on important issues of foreign policy, promote economic cooperation including greater ties between various industrial groups across national boundaries and a new currency system, and foster closer cooperation on military issues in order to create an effective defense community.

23. See Ann Sheehy, "The CIS Charter," *RFE/RL Research Report*, Vol. 2, No. 19, March 19, 1993, pp. 23–27; and Meissner, pp. 834–836.

24. The economic objectives include creation of a common economic space, establishment of a joint policy governing custom dues between CIS members, cooperation in the area of supply and transport, and facilitation of the free movement of goods and services.

25. See Sheehy, p. 25. The Council of Heads of State will "discuss and decide fundamental questions connected with the activity of member states in the sphere of their joint interests," while the Heads of Government will "coordinate the cooperation of the organs of executive power in the economic, social, and other spheres of their joint interest."

26. *Ibid.*, pp. 12–13.

27. Meissner, pp. 836, 846.

28. See *Current Digest of the Post-Soviet Press*, Vol. 45, No. 51, 1993, p. 23.

29. See *Current Digest of the Post-Soviet Press*, Vol. 26, No. 7, 1994, p. 25.

30. See *Current Digest of the Post-Soviet Press*, Vol. 46, No. 29, 1994, p. 21.

31. *Ibid.* An example of the anticipated cooperation is contained in a bilateral agreement signed a few days later between Russia and the republic of Kirgizia. Russian officers will retain their Russian citizenship while serving with Kirgizian forces, and Kirgiz officers will attend Russian military schools. And Russia will retain a number of military installations in that Republic.

32. See Ben Slay, "The Post-communist Economic Transition: Barriers and Progress," *RFE/RL Research Report*, Vol. 2, No. 39, October 1, 1993, p. 35, for a description of the main barriers to economic reform, which are "1) Problems of macroeconomic stabilization, 2) the slow pace of privatization of state enterprises and property, 3) the pathologies of post-communist banking and financial systems and 4) unresolved questions concerning the desirability of, and mechanisms for, regional economic reintegration."

33. *Ibid.*, p. 841, for a description of the final communique of the Moscow meeting, which stated that, "Following an all-embracing discussion of the conditions of economic cooperation within the framework of the Commonwealth of Independent States, the State leaders declare... their resolution to advance the way to a comprehensive integration, the creation of a common market for

the free movement of goods, services, capital and labor within the boundaries of these states, and, step-by-step to move toward an economic union."

34. See Meissner, p. 844, for the assertion in the communique: "Upon consideration of the historic partnership of the peoples of the White Russian Republic, the Russian Federation and Ukraine, the close association of their territories, the similarity of their developmental levels and the reciprocal interdependence of their economies, the three governments reached a decision for the embodiment of urgent measures for a narrow economic integration."

35. *Ibid.*, p. 846.

36. *Ibid.*, p. 849. The four stages began with establishing free trade among CIS states; stage two created a tariff union and close coordination of the foreign policies of member states; the third stage promised free exchange of capital and labor resources; and, finally, stage four envisioned a currency union.

37. See "Declaration of a Summit Meeting of Members of the Commonwealth of Independent States in Aschabad on 24 December 1993," "Dokumente zur russischen Aussenpolitik und zur Entwicklung in der Gemeinschaft Unabhaengiger Staaten (GUS)," *Europa Archiv*, Vol. 49, No. 11, June 10, 1994, p. 360, for the statement that, "Its juridical foundation is laid, the organs of multilateral cooperation in the realms of economics, defense and foreign policy are established and functioning."

38. See Suzanne Crow, "Russia Promotes the CIS as an International Organization," *RFE/RL Research Report*, Vol. 3, No. 11, March 18, 1994, p. 34.

39. See "At CSCE Summit, Yeltsin Warns of 'Cold Peace'," *The Current Digest of the Post-Soviet Press*, Vol. 46, No. 49, 1994, p. 9, (emphasis added), for the following statement by President Yeltsin: "The reliability of the CSCE will depend on the interaction in our common interest of all European organization and forums, the CIS, NATO, the Western European Union... The Commonwealth of Independent States is playing an ever greater role in the life of Europe. We have no intention of creating within the Commonwealth framework a new bloc that is opposed to anyone. ...The Commonwealth will continue to gain strength. This is the desire of our people. *This is a highly important condition for stability not only in Eastern Europe but throughout the European continent...*"

40. See Dominique Arel and Andrew Wilson, "Ukraine under Kuchma: Back to 'Eurasia?'," *RFE/RL Research Report*, Vol. 3, No. 32, August 19, 1994, p. 1. As Ukraine's new president asserted in his inaugural address, "Ukraine is historically part of the Eurasian economic and cultural space," and "the self-isolation of Ukraine and its voluntary refusal to promote its own interests actively in the Eurasian space were a serious mistake, causing colossal damage to our national economy."

41. See V. Chekurov, "Sem raz otmerit'o putiakh formirovaniia ekonomicheskogo soiuza gosudarstv SNG," *MEMO*, February 1994, p. 55, for a

critique of rapid CIS economic integration. Arguing with those who foresaw CIS developments as similar to earlier integration within the European Common Market, Chekurov noted that significant differences within the divisions of labor among CIS states make parallel evolution unlikely. Previous experiences with economic integration reveal a certain set of rules that must be followed. "They consist in this, that the greatest degree of cooperation is achieved precisely there where the partners are able to function quite well alone, but where there interaction permits each of them to achieve a quantitatively higher level of development. It is obvious that we by no means have this situation, and if the union is to be called an integrated whole, *then it is rather the kind of integration found among developing states.*"

42. V. Kudrov, "Statistika i otsenka ekonomicheskoi situatsii v Rossii v 1991–1993 gg.," *MEMO*, January 1994, pp. 28–29.

43. See "sluzhba vneshnei razbedki Rossii prognoziruet stsenarii razvitiia sobytii v SNG," *Nezavisitaia*, September 22, 1994, pp. 1–2. Primakov argued that the most important factors which encourage economic integration are, "The traditional high level of cooperation in the production sphere, which developed over decades; the single technological space and uniform standards...; the significant need for the republics to preserve reciprocal deliveries as a means of maintaining employment, and the very existence of their own industries; and the fact that instability in the economic realm within the CIS states carries a great economic risk while it is unrealistic to expect much entry of foreign capital within the near future."

Also see "Russia's Intelligence Chief Defends CIS Integration," *The Current Digest of the Post-Soviet Press*, Vol. 46, No. 38, October 18, 1994, p. 4. The fate of Russian reforms are linked to developments within the CIS. In the anti-reform alternative, "With overt or covert support from outside, forces advocating 'isolated development' will gain the upper hand in Russia and the other Commonwealth countries. This would exacerbate the economic crisis in the former national republics... and increase the social and political tension there. The rupture of economic ties and the abandonment of cooperation in the productive sphere could become irreversible. The unemployment problem would be exacerbated and a shift to an upswing in production would become difficult. This tilt in the direction of nationalism would be accompanied by the intensification of authoritarian and antidemocratic trends. The criminalization of society, infringement of the rights of ethnic minorities and mass violations of human rights would be additional destabilizing factors... General destabilization throughout the CIS would create a threat to the security of the world community."

Part IV

Conclusion

Conclusion

Democratic Opportunities in Russia: Defining US Policy for the Twenty-First Century

by William C. Martel & Theodore C. Hailes

- A. Purpose
 - B. Ten Critical Propositions About Russian Democratic Reform
 - C. Philosophical Foundation for US Policy
-

A. Purpose

The United States has reached the moment when it must redefine its policy toward Russia. Now more than ever, the objective of US policy must be to influence democratic reform in Russia in ways consistent with the realization that we have at best a marginal influence on events in Russia. The United States needs a more flexible policy that places the emphasis on creating a stable international order while managing the chaos inherent in Russian democratization.

This book is devoted to providing some guidance to help refine US policy toward Russia, and thus has several fundamental purposes. The first purpose is to focus the attention of senior policymakers in the United States on broad strategic questions about how the United States should deal with Russia during this time of turmoil. At the same time, US policymakers must focus their attention on the nature of democratic reform in Russia, for only then will it be clear how the United States should manage its relationship with Russia. Thus far, the debate in the United States has been absorbed by questions about the outcome of democratic reform in Russia and whether those are consistent with US interests.

The alternative, however, is to shift our attention to pivotal questions about the proper relationship between the United States and Russia independent of the success of democratic reform. This approach rests on the argument that, regardless of the outcome of democratization in Russia, Russia will remain an important state whose interests will not dovetail with those of the United States. It is essential that we deal with Russia as a serious state, and not one whose importance is measured by its willingness to follow our lead on strategic questions.

The second purpose of this book is to concentrate on broad guidance for the United States as it shapes its policy toward Russia. *We believe that the debate in the United States has focused far too much on tactical details about assistance to Russia* at the expense of addressing the strategic significance of the future relationship between the two states. This book is devoted to the broadest questions about the fundamental relationship between the United States and Russia, and offers the view that answers to the most pressing questions about US policy toward Russia will not be found in the details. And yet, the policy debate in the United States has foundered precisely because it concentrated on detailed aspects of support for Russian democratic reform.

The third purpose is to be precise about the true goal of US policy. While some believe that the United States can shape democratic reform in Russia, or that somehow the United States is responsible for the outcome in Russia, we argue in this book that *the only proper course for the United States is to influence Russia in its deliberations toward a democratic end-state*. It is important to note that we do not say a democracy, but a democratic end-state that reflects the unique aspirations and history of the Russian people. An even more precise formulation is to say that the United States should support the Russian people as they achieve "their" democratic end-state. Thinking in these terms has several profound implications for US policy toward Russia and the rhetoric that accompanies our policy.

To begin with, we need to acknowledge that the ultimate shape of democracy in Russia will be foreign to the observers in the United States, that Russian democratic reform may consume the

energies of generations of Russians over the span of decades if not centuries, and that Russia most certainly faces tough times in the future. *The challenge for US policy is to recognize and support the fact that Russia is under no obligation to mimic the form of democratic government that exists in the United States or in any other industrial state for that matter.*

There is also the question of whether Russian democratic reform is inevitable. The shibboleth of the mid-1990s is that democratic reform in Russia is irreversible. While we fervently hope that this is true and remain optimistic, there are no guarantees that Russia will never return to its brutal and oppressive totalitarian past with a systemic effort to crush reform. When the success of democratic reform is vital to the United States and we exert only marginal influence on the outcome, it is frustrating to realize that we have so little influence on a matter of such great importance.

In the next section, we examine the critical propositions about democratic reform in Russia in order to establish a framework for US policy in the twenty-first century.

B. Ten Critical Propositions About Russian Democratic Reform

Throughout this book we have focused on those elements of democratic and economic reform that are reshaping the fundamental nature of society in Russia. While this line of inquiry is important in understanding the nature of the monumental changes in Russia, the broader purpose is to focus the attention of US policymakers and the American people on those ideas that ultimately influence the outcome of reform.

Proposition 1: The success of democratic reform in Russia is of vital interest to the United States. For reasons enumerated throughout the book, it is obvious and beyond dispute that *the success of democratic reform in Russia is of vital importance to the United States*. We do not care simply out of an altruism which argues that all “good” societies are democratic societies — even if there is truth to the proposition. Nor are our

intentions purely noble. To state matters directly, the United States has a profound interest in seeing Russia become a democracy for the purely practical reason that democracies, by and large, are more productive members of the international system than their authoritarian or totalitarian counterparts. The American leadership is right to believe that a democratic Russia, even if it is still fraught with difficulties and growing pains, will contribute to an international order that promotes peace and prosperity. To be frank, while the United States contained the Soviet Union for nearly fifty years, and certainly can marshal the resources to contain Russia for as long as it takes, we would rather see Russia join the international community as a state whose interests are shaped by the desire to participate in economic trade and technological development.

None of this reasoning should be foreign to the Russia people. They, like the American people, understand that democratic reform in Russia raises the hope that the dismal past of economic deprivation and ideological uniformity will give way to the pluralism that fosters productive competition within Russian society. Just as the American people will not be alarmed by the argument that our interest in democratic reform in Russia rests on purely pragmatic grounds, so too will the Russian people find solace in the hope that the policies of the West are driven by self-interest. *It is time for the United States to articulate a long-range policy of support for democratic reform in Russia which rests on unadorned pragmatism.* There is no room for policies that are rooted in imprecise hopes for democracy rather than practical and utilitarian reasoning about the broad benefits to the United States if Russia becomes a democracy.

Many might argue that, in fact, the policies of the United States rest on pragmatic calculations about supporting democratic reform in Russia. But this policy has not been successful because the perception still exists that the US leadership has hesitated to express our interest in democratic reform in such terms. Nor is there any real choice. For the Russian people, if we fail to express US interests in pragmatic terms, then our policies will be seen as evoking sympathy. It is easy to cross the fine line between

sympathy and contempt, or at least disdain. We believe that the single greatest failure of US policy during the last several years is to shy away from expressing our interest in stark terms out of the fear that we would be seen as less compassionate and motivated principally by crass opportunism. Only after the United States elevates the discourse to address why we care about Russian democratic reform in these terms will it be possible to build and sustain an enduring policy of support for Russia for the twenty-first century.

Proposition 2: Russia must build a democracy from scratch. *The virtually universal law of democratic reform is that a society must build democracy on its own.* The traditional way of thinking about the evolution of communist states to democratic societies falls into two schools of thought. One argument is that an authoritarian government, which accepts the mantle of “benevolent” dictator, forcefully directs the command economy to adopt more free-market approaches in a controlled fashion — despite the risk that its actions may be politically unpopular in the society. China is an excellent example. The other argument is that, as a government chooses to pursue political and economic reform in tandem, the strategy is to modulate the reform process at a rate that is acceptable to the society. And the debate, as illustrated by Poland, is to determine the proper pace of reform. Given the speed and magnitude of the collapse of its economic system, Russia never had the luxury of choosing its path of reform. Russia’s status and influence created an environment that precluded a soft landing for the economy. A state in collapse does not have the luxury of engaging in a debate about the proper course for reform.

We must acknowledge that no modern great-power has transformed itself into a democracy without extensive assistance from the outside world. The specific examples that come to mind are Germany and Japan after World War II and South Korea after the Korean War. The critical difference between these societies and that of Russia today is that the former states were destroyed in every sense of the word. Therefore, these states were willing and anxious to receive all possible support from the United States. *Russia, by contrast, has a failed but not destroyed system, and*

therefore its need is neither as drastic nor apparent to the people of Russia or to the United States.

None of this is, however, to understate the role of the Russians in democratic reform. Tocqueville, one of the founding architects of democracy, argued that democracy is in a constant state of democratization. The ideas of freedom, limited government, and popular sovereignty, among the panoply of democratic principles, are found in various forms throughout all democratic governments, and those principles are in constant change. And while there is no universal formula for building a democratic society, it is universally true that a society as well as its people and their leaders must discover together how those ideas translate into a functioning system of government. The people, and the people alone, must learn how to craft a working system of government given their unique historical, political, economic, and cultural circumstances. We could express this principle in starkly Darwinian terms — that societies must learn to be democratic, and those that cannot will not become democracies. This tautology would have a foreboding quality were it not for the fact that the vast majority of societies, once they taste the freedom of democracy, become so enamored of the idea that they succeed in building a democratic system of government.

Amidst the chaos and confusion of democratic reform in Russia, it is easy to lose sight of these simple facts. In part, the difficulty arises from the legacy of the struggle with the Soviet Union during the cold war, when the risks of hostility were elevated to historic proportions. For that reason, the American people and their leaders are justifiably worried about the consequences for the United States if Russian democratic reform fails. It is, after all, supremely rational to consider the costs of failure when the state in question possesses 27,000 nuclear weapons.

This reasoning cannot, despite the experience of the last several years, deflect the United States from the essential though often forgotten principle of democratic reform in Russia. That is, in the final analysis, Russia — and Russia alone — is responsible for building a democracy to replace the failure of its totalitarian experiment. If democracy succeeds in Russia, *it is only because the*

*Russian people have reached deep within their political soul to do what is necessary to ensure that democratic reform lifts Russia out of chaos and disintegration. If, however, democratic reform fails, no one but the Russian people will be responsible. Prime Minister Victor Chernomyrdin expressed this thought when he said "We in Russia are fully aware of the fact that it is up to us to solve our problems."*¹

What has been true, yet unstated, needs to be expressed clearly and unequivocally. The success or failure of democratic reform in Russia has very little to do with the actions of the United States. It is beyond the ability of the United States to strongly influence either the success or failure of Russian democratic reform. But the United States has burdened itself with responsibility for the outcome of Russian democratic reform largely through the language of assistance, which implicitly argued that we have an obligation to assist Russia. Unless the policy is expressed in precise and careful terms, it is easy to infer that we are responsible for the outcome. We believe that the United States has sent the message that we bear a large share of the obligation for the outcome of Russia's attempts to build a democracy. Although the policies followed by the last two presidential administrations articulate similar themes, the message has been blurred in the political process. It is the responsibility of the administration to maintain control of the policy if the United States is to avoid confusion within the media or among the people. Finally, we must reiterate that a democracy flourishes because the people insist that it does.

Proposition 3: Building representative government is the first step toward democracy in Russia and Ukraine. The language of democratic reform encompasses a wide range of ideas and principles that must be enshrined in a society before we can say that it is a democracy. And while there is no agreement on the minimum conditions that define democracy, there is a consensus that it cannot exist without several critical elements. Such a model includes many constituents, including, "free and fair elections; separation of powers; a fair and independent judicial system; a free and inquisitive press; widespread sharing of democratic values in society; respect for human rights; and the presence of civil society."²

It is beyond argument that both Russia and Ukraine must build all of these democratic institutions if they wish to become democracies in the fullest sense. Nevertheless, the most important step for now is to strengthen the institution of representative government in Russia. *There is nothing so powerful, or so able to limit the power of individuals and institutions, as representative government.* There can be no greater and more elegant restraint on power in Russia than when the actions of the state are the product of the deliberations of a legislative body elected by the people. Only when we can say that the policies of the Russian government reflect the decisions of a legislature, which in turn reflects the wishes of the Russian people, will Russia have a representative government.

Most of the struggles within both the Russian and Ukrainian societies today are the product of confusion about which institutions and individuals represent the will of the people. While in Russia the President and Duma are popularly elected, the respective powers and responsibilities of these institutions are mired in argument. *Russian politics tend to emphasize the role of individuals rather than the political process itself.* The reason is that because the process of democratic government in Russia is not clearly developed, the Russians focus on the role of individuals in the government. We believe that Russia will gain the greatest payoff in terms of political and economic stability if it focuses on resolving the rights and responsibilities of the central institutions of the government, and accordingly diminishes the role of individuals in the political process. When these ambiguities are resolved, it will be clear that the deliberations of the Russian government reflect, however imprecisely, the will of the people. Until that occurs, politics in Russia will continue to be the product of struggles among institutions as to who speaks for the Russian people and what ought to be done in policy.

Proposition 4: Russia's command economy represents the greatest impediment to economic reform and growth. It is an article of faith that democracies can exist and flourish only when the economy produces sufficient goods and services to provide a reasonable standard of living. The typical line of

reasoning is that people find it difficult to engage in debate about democracy if they are hungry or if their society is disintegrating. The contemporary problem is that Russian society is gripped by levels of chaos and confusion that are unfamiliar to Russians who lived for seventy years under the oppressive, yet orderly, grip of totalitarian rule.

We believe that the greatest impediment to democratic reform in Russia is the disintegration of the Russian economy. And that collapse is the product of the inefficiencies of a command economy during the 70 years of Soviet rule. While there are signs that some segments are being privatized, the unyielding reality is that Russia remains in the grip of a command economy. The president, government ministries, the Central Bank, and legislative lobbies exert a powerful and pervasive influence on the Russian economy through decrees, subsidies, regulations, and taxes. By no stretch of the imagination can we say that the command economy no longer exists in Russia. However, there are encouraging signs that private economic activity is on the rise. Russia is seeing the growth of entrepreneurs in virtually all sectors of the economy, ranging from banking and construction to retail sales. A related issue may be that unleashing the entrepreneurial spirit in Russia introduces entirely new sets of problems.

It is worth emphasizing that Russia has not unshackled itself from the remnants of the command economy, and that it cannot enter a period of sustained economic growth until it does. We understand that the problem for Russia is to dismantle the command economy without driving Russia into total economic collapse. Nevertheless, the continued disintegration of the Russian economy, despite the decision to preserve many sectors of the command economy, highlights the reality that economic reform in Russia cannot accelerate until the command economy is dismantled. Finally, it is worth reflecting on one individual's recipe for economic prosperity:

Sustained economic growth calls for a framework of economic and financial stability to ensure certainty and confidence for saving, planning, investing and working productively. It calls for clear rules and fair treatment for all. Fair treatment means legal certainty in contractual relations, something that will ensure workers' rights and

promote business efficiency. Fair treatment means fighting monopolistic practices, abuses and privileges. It means precise, simple regulations to prevent corruption and promote economic activity. Fair treatment means a simple, transparent and equitable tax system, and the capacity to defend oneself against possible abuses on the part of the authorities.³

These words, spoken by President Ernesto Zedillo at his December 1994 inauguration, apply with equal force to Russia as well as Mexico.

Proposition 5: A viable judicial system is absolutely essential to Russian democratic and economic reform. The existence of a fair and impartial judicial system is one of fundamental elements of democratic reform in Russia. *A modern society cannot promote internal economic growth, encourage free-market atmosphere, and foster external foreign investments unless it has a judicial system to adjudicate the inevitable conflicts that arise among competing interests.* And Russia is no exception.

Despite the ascent of democratic reform in Russia, the judiciary has remained relatively unaffected. There is no sense that the judicial system has the power or authority to resolve disputes among contending factions, as exemplified by the struggle between President Yeltsin and the Duma. *Because the process of democratic reform encourages individuals and groups to compete for resources in Russian society, a fundamental impediment to reform is the absence of a legitimate judicial system.* How can Russia create a democratic society and thus the struggle among competing factions without a mechanism for resolving problems? The answer is that democratic reform in Russia is blocked by the absence of an independent judicial branch.

The effects of an impotent judiciary are seen throughout Russian society, but nowhere more visibly than in economic reform. It is doubly more difficult to create businesses, attract investment capital, and market goods and services in Russia without a judicial system to adjudicate the process. The reality, which the Russian people are slowly beginning to internalize, is that foreign investment is much less forthcoming when there is no legal protection for investors. If an individual has no legal

guarantee that funds invested in the Russian economy will be protected against outright fraud; if there is no way to repatriate profits from Russia; if there is no clear tax code — then far fewer investors will be willing to invest. This is not to say that Russia will not attract any foreign capital, but that there will be considerably greater incentives to foreign investment if the judicial system provides protection.

Proposition 6: Sustained economic reform builds directly upon a credible banking and financial system. A similar argument applies to the role of a credible banking and financial system in Russia. Economic reform builds directly on the ability to amass and invest capital in enterprises that show the promise of profitability. *If Russia is to accumulate the capital that will fuel economic reform and development, it must develop a banking and financial system that acts as a neutral arbiter in managing the flow of capital.*

The language of reform in the West and in Russia implicitly suggests that the capital necessary for economic development will come from the West. While there is a role for foreign investment, we believe that Russia will be better served by building a financial system to attract both foreign and domestic capital. The currency holdings of the Russians are immense, even if they possess rubles that are constantly losing value. If Russia can strengthen the credibility of its financial system, it will encourage the Russian people to put their money in banks and invest, for example, in the stock market. There are Russian companies — for example, in the oil industry — that issue stock to encourage investment and modernization.⁴ The engine of economic progress and reform must come from the Russian people. They will not invest in Russia until they have confidence that their money will be managed with care and protected from unregulated business practices.

The implication for the United States is that economic reform can be accelerated by efforts to strengthen the banking and financial systems in Russia. The United States is not obligated to provide investment capital, but to encourage Russia to ensure that it provides a secure atmosphere for investment. *The barometer of*

success is the willingness of the Russian people to invest their money in the financial sector for safekeeping rather than moving their hard currency to Western banks.

Proposition 7: Unbridled black market activity undermines Russian society and fundamentally weakens democratic reform. There is a general consensus that unrestrained criminal activity constitutes a fundamental impediment to democratic reform. There is further agreement that virtually all sectors of the Russian society are witnessing an explosive growth in criminal activity. The problem is that organized crime destroys the ability to promote democratic and societal reform at the very moment when Russia is engaged in unprecedented attempts to redefine its society.

The simple fact is that Russia needs to exercise some control over the black market. At a time when many businesses, banks, and government ministries are influenced by organized crime, it is virtually impossible for Russia to encourage the development of normal business and government practices. *Crime has the insidious effect of weakening the belief in Russian society that success is a product of labor rather than connections.* It is important for Russia to develop an atmosphere in which the people believe that investing in or building businesses is a normal part of economic activity. The Russian people also need to learn that successful economic activity, as indicated by the ability to generate profits, is a noble practice. It is difficult, however, to draw these conclusions when the consensus in Russia is that businesses are governed by unsavory elements and that successful businesses reflect distasteful practices. Thus, the black market undermines the principle that investment and business activity is healthy and productive.

The challenge for Russia is to control the more abhorrent aspects of the black market while protecting democratic reform. *Russia will lose in the end if democracy is destroyed by efforts to contain corruption.* Although a society must respond with direct action to contain serious crime, *the hidden danger is that those actions could force the society to sacrifice democratic institutions*

and political freedoms. This is an especially serious concern for Russia given the fragile and tenuous state of those institutions and freedoms. Furthermore, we must acknowledge that the fear generated by rampant crime unifies the opponents of change and gives them an instrument to bludgeon democratic reform.

At the same time, we understand that it is difficult for Russia to control the black market given that it is one of the few successful instruments for generating private enterprise in an emerging market economy. *While the black market can be antithetical to the development of an orderly economic system, these forces provide a mechanism for the unbridled accumulation of wealth in an economy that is starting from scratch — just as we witnessed in the United States in the early decades of the twentieth century.* The dangers of an unrestrained black market, however, are so great that the Russian government must act to control these excesses or face the risk of paralyzing democratic reform.

Proposition 8: Given the magnitude of rebuilding Russian society, US and Western assistance plays at best a marginal role. As stated earlier, we believe that the engine of democratic reform is the society itself rather than outsiders. The practical consequence of this reasoning is to put limits on the ability of other states to influence reform. This argument is vital because, rightly or wrongly, the debate in the West rested on the premise that we have an obligation to provide economic assistance, and that the success or failure of economic reform in Russia depended to a significant degree on the largess of the West.

Framing the debate in these terms shifted the burden of responsibility to the West and effectively undermined the rationale for providing assistance to Russia in its time of trouble. If we are somehow responsible for the outcome of democratic reform in Russia, why should we provide assistance when whatever we can provide is pitifully small compared with what Russia needs? And do we not share the blame if we provide assistance, thereby leading the Russian people to believe that we, rather than they, are responsible for democratic reform? What is the value of providing assistance that is marginal to Russia's real

needs when we implicitly assume responsibility for events that are beyond our control? Framing the debate about assistance to Russia in these terms directly undermines the reason for giving assistance in the first place.

The realization that rebuilding Russian society is a monumental task involving decades, if not centuries, diminishes expectations in the West and Russia about the role of outside assistance. *The fundamental conclusion for the United States is that assistance, either from the United States or the West, plays a decidedly marginal role in Russian economic reform.* We cannot create a free market in Russia. Free markets exist because the people within a society are determined to exchange goods and services in an atmosphere that is devoid of government intervention to the maximum possible extent. The failure of the command economy signals that the Russian people are dissatisfied with the past. It is up to them to build a free market, and for the outside world to understand that we have quite a limited role.

Once that framework for policy is established, the United States and the West are freed to encourage private sector investment in Russia. Perhaps it is necessary to remind ourselves that the private sector creates vastly more jobs than the government, and that Russia needs to attract investments from the private sector to rebuild its economy. The danger, as events have already borne out, is that US assistance to Russia rarely reaches its intended target, and often is diverted to bank accounts in Switzerland and elsewhere.

Proposition 9: Economic reform will occur only as Russia dismantles its obsolete industries. *Virtually all of Russia's industries are obsolete, inefficient, and cannot compete with their western counterparts.* Russian industries are burdened by technologies that are a generation or more behind those in the West, labor costs which vastly exceed what a firm can sustain, and environmental damage that dwarfs any conditions found in the West. The unavoidable and painful conclusion for Russia is that most of its industrial base — which still produced roughly 30 percent of the economic output in Russia in November 1994 —

must be dismantled if Russia ever wants to compete in the global economy.

The magnitude of this problem is almost beyond comprehension. Russia's industries employ tens of millions of Russians and produce most of the goods, even if they are primitive by Western standards. Russia faces economic dislocation on an enormous scale, and confronts the equally grave possibility that its economy could collapse. One out of three jobs in Russia exist are in a private sector that hardly existed several years ago. Yet, we can argue that the first one-third is the easiest to transform into private sector jobs. *Nevertheless, Russia cannot hope to reap the benefits of economic reform until its giant industrial enterprises are allowed to atrophy and dissolve.* The longer these reforms are delayed — largely because Russia wants to create a "soft landing" for the economy that minimizes the risks of massive unemployment and preserves the willingness of the Russian people to support economic reform — the longer it will take for Russia to build a market economy. This may be a fair and necessary compromise given that the alternative of economic shock therapy, massive unemployment and perhaps even civil war, has more immediate and dire consequences.

We believe that the eventual fate for many Russian industries is dismantlement. The great illusion, however, in both Russia and the West is that these industries — burdened by old technology, expensive workers, and no market experience — can be converted to consumer production. *In a global economy where market niches are measured by infinitesimally small differences in price and productivity, it is naive to assume that these industries could produce goods for the increasingly savvy Russian consumer that will compete with western goods.*

The idea of defense conversion is a hopelessly simple solution to a vastly more complex problem. It stems from the tendency of governments, which look for governmental solutions to economic problems, to be notoriously inefficient when it comes to creating economic growth. The governments in the United States and Russia succumbed to the illusion that Russia can convert its industries into modern structures which are competitive with the

West. This is a particular dangerous concept for Russia because it harkens back to days of a government-planned command economy. Our view is that Russia has no choice but to dismiss the illusion of defense conversion and proceed to address the real problem of managing the transition to post-communist industries that are competitive in the global economy.

Proposition 10: Russia's military plays a pivotal role in both internal democratic reform and external security. The political balance within Russia is shaped to a considerable extent by the Russian military. *The military is one of the few institutions in Russia that can sidetrack, if not stop, democratic reform.* As long as the military is willing to support democratic reform there is a reasonable chance that these reforms will succeed. It is no exaggeration to say that the progress seen so far in Russia is attributable in no small measure to the support of the military. If the military does not interfere in Russian politics, we can be hopeful that reforms will endure. It is a pivotal force in Russian politics today.

The behavior of the military also influences Russia's image in the world. As seen by the events in Chechnya, the combination of incompetence and brutality demonstrated by the Russian military increases concerns among states in the region that the old Russian habits have not died with the birth of democratic reform. The broad conclusion is that the deployment of military forces in Chechnya reinforces the impression that Russian imperialism is still a concern for Russia's neighbors.

C. Philosophical Foundation for US Policy

For the last several years the United States has been consumed by debates about whether Russia will succeed in its democratic transformation and what we can do to assist Russian reforms. It is apparent that the United States needs a strategy to guide its actions. In the early years of the cold war, George Kennan made the connection between Soviet ideology and US national interests that determined our policy for 50 years. During the same era, George Marshall demonstrated how US assistance to the defeated

nations of World War II supported the development of strong democratic states. Once again, we need to focus the attention of the United States on the philosophical underpinning of our policy toward Russia in its moment of democratic reform. The remainder of this chapter examines some of the ideas that can help the United States with these difficult policy choices.

Dampen "Sine Waves" During Reform. The ultimate objective of American policy must be to dampen the swings in the "sine waves" that occur during democratic reform. *Our goal is not to rebuild individual sectors of Russia incrementally, but to use our resources and goodwill to help Russia avoid the extremes that can destroy democratic reform before it has the opportunity to succeed.* By this, we mean that the United States must help Russia steer around the two prominent dangers that are spawned by reform.

At one extreme, there is the danger that Russia will shift to the right as the forces of nationalism take control of a people who are disillusioned by the loss of order and control in their society. The risk is that this political shift will create a strong potential for civil war that returns Russia to its authoritarian past. The other extreme is to see Russia slip into anarchy or civil war because the reform movement pushes the economy beyond its ability to sustain the people. While radical economic reform can succeed in the long term, the short-term dislocation can be so severe that it destroys the ethic of economic reform. As a result, Russia could collapse into social and economic chaos that leads to massive unemployment along with the deterioration of the basic institutions of Russian society. *Whether the "sine wave" moves between the extremes of ultra-nationalism and radical reform is less relevant than the fact that both extremes push Russia toward the abyss of social upheaval and civil war.*

We believe that US policy must act as a buffer against these extremes to prevent the disintegration of Russia. Our policy must, in effect, seek to dampen the amplitude of the "sine wave" in order to prevent Russia from sliding from peaceful democratic reform to anarchy and violence. To cite but one example, if we were to see the collapse of Russian agriculture, the United States and the West could easily provide ample food assistance to feed the Russian

people and thereby avert civil war. In fact, the United States was prepared to provide massive supplies of food in late 1991 and early 1992 if the Russian agricultural system had collapsed during the first months of democratic reform. As a buffer against catastrophic failure, the United States should use its resources and goodwill on those occasions when Russia seems headed toward the abyss of chaos.

Marginal Role Versus Significant Difference. We need to understand that the United States, like all other societies, can play only a marginal role in Russian democratic reform. The objective for US policy is to steer a middle course between the doomsayers who argue that Russian democratic reform will collapse without massive assistance from the United States, and those who argue that the United States can do no more than watch, and hope, as Russia struggles with reform. We believe that the United States does not have the power or resources to ultimately guarantee that Russia will become a democracy. And if that is what is meant by significant difference, then it is clear that the role of the United States is to operate at the margins — by inserting ourselves in order to help Russia buffer itself from the disintegration that kills democratic reform.

No Single-Point Reforms. It is exceedingly clear that outside governments, including the United States, cannot resolve individual problems in Russian society. The theme of most reform efforts is to focus on specific sectors of the Russian economy or government in the hope that a program or initiative can fix the problem. The problem, however, is that we do not understand how individual sectors of the Russian economy and government relate to one another. By virtue of the law of unintended consequences, efforts to target one sector of the economy may impede reform in others. In almost all cases, the tendency is for a few people to be helped while many are bypassed or hurt by reform. And for the majority that is bypassed, it is likely that they will have more harsh than kind words for the United States.

This tautology of reform doubly complicates the efforts of both the Russians and outside states to influence democratic reform. The problem is that reform involves changing the relationships

among political, military, economic, and societal institutions when their relationships with one another are often unclear. It is difficult to know where reform should begin or to understand whether assistance in one sector of the society impedes or helps reform in another sector.

US Policy Must Integrate Reform Efforts. A parallel problem with US policy is that the components of democratic reform tend to be studied in isolation. While it is normal to break a problem into its constituent parts, the temptation to try to solve each of these while still in isolation leads to a failed policy because the interaction of the system or its complexity is not taken into account. The correct approach must be to reconstitute the knowledge gained from the study of the constituent parts into a coherent and broad policy. *This acknowledges the danger that solutions to individual problems may be counterproductive when applied to the greater issue of democratic reform.*

It is essential for the United States government to understand that our fixation with single-point reforms is a product of governmental departments breaking the problem of Russian democratic reform into bureaucratic pieces. While this is an efficient approach, it suffers from the danger of failing to reintegrate the pieces *before policy is developed*. The United States must integrate all forms of assistance in ways that avoid the tendency to focus on individual parts of the Russian economy and society. To increase the chances that Russian democratic reform will succeed, the United States must focus its efforts on framing assistance in the broadest possible terms and thereby diminish the tendency to view reform as a series of single-point corrections. Democratic reform — or the process by which a society builds a democratic political culture — is not an engineering problem but a problem of metaphysics.

US Interests, Not Responsibility. It is essential for the United States to differentiate between its interest in the success of democratic reform in Russia and the myth that we are responsible. We believe that the United States has a clear interest in the success of Russia's democratic experiment, but this interest does not translate into a responsibility. The Russian people, and the Russian people alone, are responsible for the outcome of

democratic reform. The United States has failed to communicate this fundamental distinction, which has the effect of blurring our role. The rhetoric of US policy often confuses this point, and reinforces the belief that we are implicitly responsible for the outcome.

We also want to emphasize that the United States has more than a strategic interest in the success of Russian democratic reform. At the risk of elevating rhetoric above pragmatism, the United States feels an obligation to assist Russia because it is the right thing to do. While a democratic Russia will not be a panacea for all the world's ills, and a democratic Russia will still be a strategic competitor of the United States, *it is fundamentally true that a democratic Russia will play a more constructive role in international politics.* We have an obligation to assist Russia's transformation to the best of our ability as long as we remain within the limits articulated.

"Seeding the Future." The hope is that the United States will be able to offer limited assistance to Russia, while maintaining the principle that Russia is responsible for the success of democratic reform. The United States can have influence at the margins by providing some of the seeds — in encouragement, technical assistance when requested, private sector investment, and support for democratic institutions — that we hope will bloom into a democracy over the next 50–100 years. Russia is engaged in a long-term effort to build a democratic state. *The criterion by which the United States will judge success is whether the amplitude of the "sine wave" stays within peaceful limits.*

In conclusion, this book isolates the construct known as Russian democratic reform into its fundamental pieces. But while we identify solutions in individual cases, these solutions are found to be wanting when examined from the broader context. While they may solve small parts of an issue, the unfortunate consequence is to create greater problems in other sectors. From this inquiry, we draw the following conclusion.

It is axiomatic that the United States must make a very basic choice about the nature of its policy toward Russia. The first option, which we reject, is the "do nothing" strategy. To sustain this strategy, the United States would have to believe that Russia is

not a vital interest and that Russia can achieve democratic reform without external assistance. The second option, which is equally untenable, argues that the United States has an obligation to provide "all-out" assistance to Russia. The fatal flaw with this argument is the assumption that the United States has the fiscal resources and political will to support a program vastly greater than the Marshall Plan after World War II. It also assumes that the United States accepts responsibility for the success or failure of democratic reform, and further implies that we could implant our political and economic culture in another society.

The remaining option is a strategy of "limited assistance." By explicitly recognizing the dangers inherent in the other approaches, this strategy pursues the appropriate middle ground which balances the need for some action with the realization that the United States cannot accept responsibility for Russian democratic reform. With this strategy the United States can help the Russian people avoid the extremes of societal collapse, while giving them an opportunity in a period of peace to construct their own concept of democracy for the twenty-first century.

Notes

1. See Address by Prime Minister Victor Chernomyrdin to US-Russia Business Council, Washington DC, June 23, 1994, p. 4, as cited in Angela Stent, "Russia's Economic Revolution and the West," *Survival*, Vol. 37, No. 1, Spring 1995, p. 136.

2. See Rutland, "Has Democracy Failed Russia," p. 4, for this approximation of the democratic construct.

3. See David Asman, "Mexico's New Law and Order Administration," *Wall Street Journal*, December 9, 1994, p. A17. President Zedillo also "singled out small- and medium-sized businesses as the focus of his larger concern toward establishing a clear legal framework."

4. See Neela Banerjee, "Russian Oil Company Tries a Stock Split In the Soviet Style," *Wall Street Journal*, February 15, 1995, p. A14; "Lukoil Plans Offering," *Wall Street Journal*, February 15, 1995, p. A14, for a stock offering to foreign investors.

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